ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

MACROECONOMIC REFORMS IN INDO-CHINA
LESSONS FROM THE DEVELOPMENT EXPERIENCES OF INDONESIA, MALAYSIA AND SINGAPORE

UNITED NATIONS

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PREFACE

The Indo-Chinese countries comprise Cambodia, the Lao People's Democratic Republic and Viet Nam. The pace of economic development in this group of economies has been mixed. While the economy of Viet Nam has forged ahead quite rapidly during the last half decade or so, Cambodia and the Lao People's Democratic Republic have made slower but significant economic progress during the same period. However, all these countries are committed to transforming their economies from centrally planned to market-based systems. In order to meet this goal, policy makers face the daunting task of instituting and implementing a range of macroeconomic and institutional reforms.

These national initiatives to reform and restructure the economies in transition in Indo-China can be strengthened by drawing lessons from the experiences of other developing countries, particularly those belonging to the Association of South East Asian Nations (ASEAN) of which Viet Nam has already become a member. Apart from their geographical proximity, the economies in Indo-China share many similarities in terms of culture and resource endowments with some of the dynamic ASEAN countries.

The ASEAN countries, as a group, particularly Indonesia, Malaysia, Singapore and Thailand, have had long periods of high rates of economic growth, aided by successful programmes of macroeconomic reforms which have promoted and enhanced international competitiveness and economic stability in their economies. Their achievements in accelerating domestic savings and attracting inflows of foreign investment have been remarkable. They also have an excellent track record in prudent external debt management. Thus, the economies in Indo-China can profit from the experiences of the ASEAN countries in the mobilization and effective utilization of domestic and external financial resources.

The set of three papers included in this volume analyses the development experiences of Indonesia, Malaysia and Singapore and examines the relevance and applicability of these experiences to the economies in transition in Indo-China. While it may not be feasible readily to transplant some of the specific policies and measures that have been presented and discussed in these papers in the Indo-Chinese countries, these papers contain insights which should provide useful guidelines for policy formulation in the Indo-Chinese countries and assist them in the design of policies to accelerate the process of sustained equitable growth.

The generous financial support of the Government of Japan for these studies is much appreciated.

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I. THE DEVELOPMENT EXPERIENCE OF INDONESIA: LESSONS FOR THE ECONOMIES IN TRANSITION IN INDO-CHINA*

A. INTRODUCTION

The countries of Indo-China, Cambodia, the Lao People's Democratic Republic, and Viet Nam, are among the least developed countries in Asia and may be able to learn useful lessons from their neighbouring South-East Asian countries which have been more successful in attaining their goals of economic development. Indonesia is certainly one of those dynamic South-East Asian countries that can provide a good model for the Indo-Chinese countries. Indonesia's economic achievements over the period 1965 to 1990 have been successful by almost any comparative economic and social indicators. This country has not only moved into the ranks of the World Bank's group of "lower middle income countries", but it has also been classified, together with Malaysia and Thailand, among the select group of developing countries destined to become newly industrialized countries.

During the period 1965-1990, the gross domestic product (GDP) of Indonesia increased at an average rate of nearly 7 per cent per year. Also, there has been a sharp reduction in the incidence and severity of poverty and significant improvements in a range of other social indicators. The number of people in poor households has been reduced significantly from 70 per cent of the total population in 1967 to 15 per cent in 1993.

The economy has also undergone substantial structural change, led by an oil commodity boom in the 1970s and more recently by an expansion in manufacturing. The share of agriculture in total output has been decreasing, and there has been a significant shift towards the manufacturing and services sectors. The experience of Indonesia in the implementation of its reform programme goes against the usual sequence of policy reforms (James and Stephenson, 1994).

This study has three objectives. First, it examines the development experiences of Indonesia over the period 1965-1990. Second, it explores the policy lessons which may be relevant for the economic development of the Indo-Chinese countries. Finally, this study discusses lessons from the Indonesia experience which are applicable to the Indo-Chinese economies.

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The paper is organized as follows. Section B provides a brief overview of Indonesian economic development plans, strategies and policies between 1967 and 1993 as the background to the paper. Section C discusses Indonesia's economic development and its achievements in 1965-1991. Section D examines the factors behind the Indonesia's success in economic development over the selected time period. In this regard, the discussion will focus on macroeconomic management, financial resource mobilization, institutional requirements and regional economic cooperation. Section E examines the economic profile, policy reforms, achievements, problems and prospects of the Indo-Chinese economies. Section F then considers the policy lessons relevant to and applicable in the Indo-Chinese countries. Section G presents some concluding remarks.

B. OVERVIEW OF ECONOMIC DEVELOPMENT PLANS, STRATEGIES AND POLICIES, 1969-1993

Indonesia's efforts to improve its economic performance and living standards began effectively in 1969 when President Soeharto came to power. A series of five-year development plans, locally known as Repelita, were launched with this aim in mind. Five Repelita were adopted during the period 1969-1993: Repelita I (1969/1970-1973/1974), Repelita II (1974/1975-1978/1979), Repelita III (1979/1980-1983/1984), Repelita IV (1984/1985-1988/1989) and Repelita V (1989/1990-1993/1994). The sixth five-year development plan commenced in April 1994 and will continue until the year 1998/1999.

The main aims of Repelita I were to stabilize the economic system through a reform of monetary and fiscal policies, to rehabilitate sectors damaged by previous government policy and to establish a substantial rate of growth of per capita income. The slogan of Repelita I was "stabilization, rehabilitation and development".

To finance its development efforts for this Repelita, the Government was heavily dependent on foreign funds. About 59 per cent of its development expenditure was financed by foreign aid, 14 per cent by private capital inflows, with government saving and domestic private saving accounting for only 16 and 11 per cent respectively of the development budgets (Azis, 1994).

The development emphasis of Repelita I was on agriculture (especially rice) production, clothing manufacture, improvement in infrastructure and housing, expansion of employment, expansion of mineral and manufacturing industries and spiritual welfare. About one third of the development budget was allocated to the agricultural sector where it was used mainly for rehabilitating irrigation facilities and other agriculture infrastructure. All these initiatives were basically intended to give farmers greater opportunities for economic self-improvement.

Unlike Repelita I, which was narrowly oriented towards economic growth, the second Repelita, which covered the period 1974/1975 to 1978/ 1979, placed more emphasis on social welfare and general aspects of development. During these years, agriculture, industry and mining, electricity and communication were allocated relatively less of government development resources, while more was given to education and health services. New allocation categories such as trade and cooperatives, manpower and tansmigration and regional development appeared in Repelita II. Also, more emphasis was put on problems which had not been overcome in the first Repelita. Greater emphasis was placed on obtaining a more equitable distribution of income, greater employment opportunities and "non-economic" goals.

Equity issues were taken even more seriously in Repelita III. In Repelita III, the development objectives were an equitable distribution of development activities to produce widespread social justice (equity), a high rate of economic growth and a sound, dynamic state of national stability. These three interrelated development goals were locally known as the "development trilogy".

Eight requirements for achieving economic and social equity were proposed: (a) an equitable distribution of access to means of fulfilling basic human needs, especially adequate food, clothing and shelter; (b) an equitable distribution of access to education and health services; (c) an equitable distribution of income; (d) an equitable distribution of employment opportunities; (e) an equitable distribution of access to business opportunities; (f) an equitable distribution of opportunities for individuals to participate in development, particularly for the young and women; (g) an equitable distribution of development effort throughout the various regions of the country; and (h) an equitable distribution of opportunities to obtain justice (Booth, 1992).

Owing to the considerable fall in world oil prices in 1982, the Indonesian Government faced many difficulties in Repelita IV (1984/1985-1988/1989) in financing its development efforts. The Government introduced a very austere budget and followed with a variety of other measures to meet this crisis. In Repelita IV, the Government shifted emphasis from oil- dependent growth towards long-term growth based on non-oil exports and on the non-tradeable sector. Also, it altered the composition of overall investment by reducing the share of the public sector in investment and increasing private investment (Booth, 1992; Hill, 1992).

Faced with uncertain global trade prospects, the Indonesian Governemnt in Repelita V continued to encourage export diversification with reduced dependence on oil exports. Furthermore, an effort was made to increase domestic tax revenues, not only to replace revenue lost from the oil company tax, but also to reduce reliance on foreign aid and borrowing as a source of development finance and to allow aid flows to be used for paying back interest and principal on existing foreign debt (Booth, 1992).

There were some interesting patterns in the development expenditure in Repelita V. Agriculture, transportation and tourism, and education accounted for 50 per cent of public outlay. Within the agricultural sector, in particular, about 37 per cent of the total budget was used for irrigation rehabilitation and extension, a further 36 per cent for the cash crop sector and 17 per cent for the food crop sector. It is also interesting to note that, in this period, the Government removed the subsidy on pesticides but retained the fertilizer subsidy, albeit at a lower rate. Within the transport sector, the Government built roads, which accounted for nearly 60 per cent of the total budget, while the balance of 40 per cent was spread between rail, sea, air and river transport infrastructure. The public budget in the education sector focused on expanding access to the upper levels of the education system. The sectoral distribution of the development budget for the five Repelita is shown in table I.1.

Table I.1. Indonesia: Sectoral distribution of government development budgets for the five Repelita, 1969-1993

Sector	*Repelita*				
	I	*II*	*III*	*IV*	*V*
Economic	78.5[a]	65.5	64.8	59.9	61.8
Agricultural and irrigation	30.1	19.1	14.0	12.9	16.1
Industry	5.4	5.4	2.0		
Mining and energy	12.7	10.9	13.5	15.3	10.4
Transport and tourism	21.7	15.8	15.5	12.3	19.1
Trade and cooperatives	–	0.7	0.9	1.2	1.3
Manpower and transmigration	–	1.3	5.7	5.9	2.9
Regional development	–	17.7	9.8	6.9	10.0
Social	16.1	16.4	17.3	23.6	25.9
Education	8.9	10.0	10.4	14.7	15.8
Religion	3.3[b]	0.8	0.7	0.7	0.2
Health and family planning	3.9	3.7	3.8	4.4	3.8
Housing and water supply	–	1.9	2.4	3.8	6.1
General	5.4	18.4	18.0	16.4	12.3
Law	–	0.6	0.9	0.8	0.3
Defence and security	2.6	2.4	6.8	6.7	5.4
Information	–	0.5	0.7	0.6	0.4
Science and technology	–	1.9	2.0	2.3	2.4
Government apparatus	–	2.3	2.7	1.3	0.6
Business development	–	10.7	1.7	2.2	1.6
Environment	2.8	n.a.	3.2	2.5	1.6
Total	100.0	100.0	100.0	100.0	100.0

Source: C.M. Firdausy and C. Tisdell, 1989. Indonesian economic development plans, achievements and policies, 1967-1988, *Asian Journal of Economics and Social Studies*, 8(2).

Note: – indicates categories not listed in Repelita I.

[a] includes 4.7 per cent for rural development;

[b] includes other social sectors.

In the present Repelita VI, the Government will continue to work towards its goal of high and sustained economic growth in its development strategies. Deregulation and de-bureaucratization in many development areas (for example, investment, trade and agriculture) have been given more emphasis in order to reduce economic inefficiency. In June 1994, for example, the Government introduced two deregulation measures relating to foreign direct investment and export market penetration. Also, in April 1994, the Government introduced a special programme of rural assistance to "village left behind" (or locally known as Inpress Desa Tertinggal). Environmentally sound economic growth will continue to be pursued in Repelita VI. All in all, it is expected that through these policy measures the Government can further build a strong economic foundation towards the second long-term (25 years) development.

To sum up, the Indonesian economic development strategy since 1969 has been varied. While economic growth has been the main focus, a reduction in poverty and inequality has also been aimed for. Policy measures to achieve rapid economic growth include macroeconomic management, financial resource mobilization, openness to foreign investments, institutional improvement in the market economy and regional economic cooperation, to name a few. In terms of its programmes to reduce poverty and inequality, the Government adopted direct measures, including rural development programmes (provision of agricultural and rural infrastructure), basic needs and/or human capital programmes (education and health care services), population programmes, expansion of employment opportunity and encouragement of technological change.

C. ECONOMIC DEVELOPMENT AND PERFORMANCE, 1960-1991

The results achieved by economic policy reforms over the period 1965-1990 have, in many respects, been quite extraordinary. Indonesia, in 1965, was a "basket case", its economic problems at least as serious as those of today's least developed countries in Asia and Africa. Triple digit inflation (600 per cent per annum) in 1962-1967 was reduced to 18 per cent per annum by 1968-1970, and from 1970 to 1993 the annual inflation rate was constantly under 10 per cent per annum.

In terms of real per capita income, 25 years ago Indonesia was one of the poorest countries in the world with a per capita income of only $50. Since then, it has made great strides and achieved a per capita income of

$700 in 1993, implying a substantial improvement in living standards. Indonesia is now grouped as the low middle income group of countries (World Bank, 1993a; Leipziger and Thomas, 1994). In terms of GDP growth, Indonesia's growth over the period 1988-1991 was at an average of almost 7 per cent per annum, a growth performance that ranks among the ten fastest in the world and on a par with that of the dynamic East Asian economies. The growth rates of some selected economic indicators since 1960 are summarized in table I.2.

Table I.2. Indonesia: trends in selected economic indicators, 1960-1991
(Percentage)

Indicator	*1960-67*	*1967-73*	*1973-81*	*1982-88*	*1988-91*
GDP growth	1.7	7.9	7.5	3.3	7.1
Non-oil GDP growth	1.7	7.3	8.0	4.3	7.7
– Agriculture	1.6	4.1	3.4	2.9	3.0
– Manufacturing	1.0	9.5	14.1	5.2	11.0
– Services	2.0	9.0	10.0	5.0	7.8
Fixed investment	1.1	23.5	11.7	-0.5	13.5
– Public	..	..	11.0	-2.0	8.2
– Private	..	..	12.3	0.7	16.9
Non-oil exports	2.1	25.6	0.0	7.6	16.5
Per capita GDP	-0.5	5.5	5.2	1.3	5.3
Per capita income	-0.4	5.6	9.1	-0.2	5.1
Per capita consumption	-0.6	3.0	5.5	1.4	5.0

Source: Bhattacharya, A. and Pangestu, M., 1993. *The Lessons of East-Asia: Indonesia Developemnt Transformation and Public Policy*, Washington DC, World Bank, p.6.

High growth in Indonesia has been accompanied by equally rapid structural change. As can be seen in table I.3, in 1965-1990 the economy underwent substantial structural change. First, it became much more open, with total trade flows in 1990 accounting for 55 per cent of GDP. Such growing openness of the economy was spurred by the oil and commodity boom of the 1970s and, more recently, by the acceleration of non-oil exports. Second, investment and savings rates rose steadily from their low levels in the early and mid-1960s to a peak in 1981, but then declined a little in the aftermath of external shocks. Third, there has been a rapid change in the composition of output. By 1990, the share of the non-agricultural sector rose to more than half of GDP (64 per cent), while the corresponding share of agriculture was 36 per cent.

Although the share of the agricultural sector to total GDP has been decreasing, this sector still represents a primary source of income and employment for more than half of the labour force. In addition, there has been a notable record of agricultural development, namely, the dramatic success of rice self-sufficiency, especially over the decade 1977-1987. Such an achievement converted Indonesia from the largest rice-importing country in the world to virtual self-sufficiency by the mid-1980s, a situation that has been maintained broadly since then.

Furthermore, while oil and mining were the dominant sector during the 1970s, manufacturing has since emerged as a major sector, making the largest contribution to overall growth in the second half of the 1980s. By 1988, Indonesia already had the eighth largest manufacturing sector (in terms of value added) among all the developing countries after China, Brazil, the Republic of Korea, Mexico, India, Argentina and Turkey. Although Indonesia is not yet a newly industrialized economy (NIE) by OECD standards it is well on its way to becoming a "near-NIE".

Fourth, with the stagnation in oil output and the sharp decline in oil prices in the 1980s, Indonesia's reliance on oil revenues has diminished in terms of both foreign exchange earnings and budgetary contribution. Fifth, there has been a significant shift towards the private sector following the reforms of the 1980s. The private sector's share of total investment has increased and it is estimated to have contributed 73 per cent of overall growth since 1983. Lastly, the level of external debt, which was reduced during the 1970s, has risen sharply during the 1980s so that Indonesia is among the five largest developing country borrowers in the world (Bhattacharya and Pangestu, 1993).

Accompanying these high rates of economic growth and structural change, there has been equally rapid technological change within most sectors. Extremely labour-intensive technologies in agriculture, industry and services began to disappear slowly. Such rapid technological change is considered to be essential as a prerequisite for a broad-based increase in Indonesian living standards (Thee, 1994).

Furthermore, Indonesia's record of poverty alleviation has been regarded as an international success story (Booth, 1992; World Bank, 1993a). The World Bank *World Development Report 1990* found that, over the last two decades, Indonesia achieved the highest annual average reduction in the incidence of poverty among all the countries studied. The number of poor had dropped sharply from around 70 million people, or 60

Table I.3. Indonesia: structural change, 1965-1990

Indicator	*1965*	*1970*	*1980*	*1990*
As percentage of GDP				
Openness:				
Total trade	14.0	22.2	46.8	54.7
Non oil exports	4.0	7.0	11.5	15.7
Imports	7.5	10.6	15.5	26.3
Gross domestic investment	8.0	10.8	28.7	24.6
Gross national savings	7.9	9.5	32.8	26.3
Sectoral shares:				
Agriculture	55.0	47.5	24.3	35.9
Manufacturing	8.5	10.9	13.4	18.8
Other industry	6.5	8.9	29.7	19.1
Services	30.0	32.7	32.1	26.1
External debt	50.0	32.5	30.0	66.6
As percentage of exports				
Oil LNG exports	40.0	40.5	78.5	44.8
Debt service ratio	11.0	6.0	13.9	27.3
Private investment as percentage of total investment	n.a.	n.a.	51.0	64.7

Source : Bhattacharya, A. and Pangestu, M., 1993. *The Lessons of East-Asia: Indonesia Development Transformation and Public Policy*, Washington DC, World Bank, table I.2.

per cent of the population, in 1967 to 27 million, or 15 per cent of the total population, in 1993. Even during the difficult adjustment period in the 1980s, poverty reduction was sustained. Thus, the poor on the whole gained benefits from economic growth while the rich undoubtedly became richer (Booth, 1992; Bidani and Ravallion, 1993; Firdausy, 1994).

In terms of income inequality, recent estimates by the Indonesian Central Bureau of Statistics (1992) confirmed that in 1978-1990 there was a tendency for income distribution to become more equal in both urban and rural areas. Using Gini ratios and the World Bank criteria, it was estimated that in urban areas, the percentage of expenditure by the 40 per cent of the population with the lowest income increased from 17.4 per cent in 1978 to 19.7 per cent in 1990, while the Gini ratio decreased slightly from 0.38 to 0.32 during that period. In rural areas, the percentage of expenditure by the 40 per cent of the population with the lowest income increased from 19.9 per cent in 1978 to 24.4 per cent in 1990, and the Gini ratio decreased from 0.34 to 0.25.

Other development achievements after 1966 include improved social indicators and infrastructure. Infant survival, life expectancy, literacy, school enrolments and access to health services have all improved substantially. Cross-country comparisons of social services show Indonesia catching up fast with its East Asian neighbours, despite having a much lower income level and starting from a much lower base (table I.4).

Table I.4. Indonesia: comparative indicators of social development for Indonesia and selected developing countries, 1960 and 1990

Country	*Life expectancy*		*Infant*[a] *mortality*		*Adult*[b] *literacy*		*Primary enrolment*		*Secondary enrolment*	
	1960	*1990*	*1960*	*1990*	*1960*	*1990*	*1960*	*1990*	*1960*	*1990*
Indonesia	41	62	159	61	61	23	71	118	6	47
Philippines	53	64	134	41	28	10	95	111	26	73
Malaysia	54	70	105	16	42	22	96	96	19	29
Thailand	52	66	149	27	32	7	83	86	13	28
Republic of Korea	54	71	120	17	29	4	94	108	27	86
India	43	59	165	92	72	52	61	98	20	43
Sri Lanka	62	71	71	19	25	12	95	107	27	74
All developing countries	46	63	233	69	n.a.	40	n.a.	105	n.a.	43

Source: World Bank, 1993. *Indonesia: Sustaining Development*, Report No. 11737-IND, Country Department III, East Asia and Pacific Regional Office, Washington, DC, p. 7.

[a] Number of infants per thousand live births, in a given year, who die before reaching one year of age.

[b] Proportion of the population over age 15 who cannot, with understanding, read and write a short, simple statement on their everyday life. Base period illiteracy rate is for 1960 except for: Indonesia and India (1961); Malaysia (1970); and Sri Lanka (1963).

In summing up, the economic achievements of Indonesia have been striking. This country has achieved sufficient economic growth to transform it from a country with a very low level of per capita income by world standards to being a middle income country. GDP growth was almost 7 per cent per annum in 1965-1990, far above the average for low and middle income developing countries and comparable with other East Asian economies. During this period also there has been considerable restructuring of the Indonesian economy with considerable expansion of the manufacturing sector. The incidence of poverty and income inequality showed a declining trend. At the same time, infant mortality has fallen sharply, and life expectancy has increased by 20 years. Universal primary education has been achieved, secondary and tertiary enrolments have risen sharply and adult illiteracy has dropped by almost two thirds.

D. WHAT EXPLAINS INDONESIA'S ECONOMIC SUCCESS?

What then explains the success of Indonesian economic development during 1965-1990? Several explanations have been advanced in the literature. Bhattacharya and Pangestu (1993), among others, for example, suggest that the success of Indonesian development in 1965-1990 was the result of the continuity of Indonesian policies relating to macroeconomic management, agricultural and rural development, improvements in social conditions and human resource development, infrastructure, financial liberalization, industrialization, and institutional set-up.

Petri (1994) suggests four broad explanations for Indonesia's miracle that also apply to the other East Asian countries: first, the existence of a stable macroeconomic environment conducive to investment and enterprises; second, the use of powerful market or non-market incentives to guide resources and initiatives into efficient activities; third, the existence of a dynamic engine of growth to provide leadership for developments; and, finally, the "contagion effects" of rapid progress and successful policies.

Therefore, the success of Indonesian economic development was certainly due to economic policy reforms. These economic policy reforms included changes in government policies, institutional structure or administrative procedures designed to alter economic activity and improve performance through greater reliance on market forces.

The reform process undertaken addressed both stabilization and structural adjustment. The reforms with respect to stabilization included the correction of imbalances in foreign payments, government budgets and the money supply. These aimed at controlling inflation and reducing macroeconomic instability. The structural adjustment reforms encompassed measures aimed at changing the structure of production (towards tradeable goods) and consumption (towards non-tradeable goods) and increasing the efficiency and flexibility of the economy. The structural adjustment policies included: (a) policies to promote outward-orientation or export expansion, (b) liberalization or deregulation, (c) privatization, and (d) institutional reforms.

It is worth noting that the nature and types of economic policy reforms undertaken by the Indonesian Government in 1965-1990 varied depending upon the particular crisis or shock facing the Indonesian economy. Azis (1994) classifies those crises or shocks into three periods. The first is the political and economic crises of the 1960s. The second is the Pertamina crisis (1973-1982) and the third is the collapse of the oil boom or the crisis of the 1980s. A chronology of reforms conducted during these three periods is presented in table I.5 and I.6. The following discussion highlights some economic policy reforms which are considered relevant for the Indo-Chinese countries, namely, macroeconomic management, financial resource mobilization, institutional requirements for a market reforms, and regional economic cooperation.

1. Macroeconomic management

After the New Order Government came to power in 1967, a series of macroeconomic stabilization and market-minded reforms were launched by the Indonesian Government. These were undertaken particularly in response to hyperinflation and political instability. Macroeconomic stabilization policies adopted by the Government included a drastic expenditure cut and the adoption of a "balanced budget" policy prohibiting domestic financing of the budget either in the form of debt or in the form of money creation. A stringent monetary programme was also adopted to bring down inflationary pressures. The exchange rate was adjusted to realistic levels through large devaluations and the administered system of foreign exchange allocation was gradually replaced by a market mechanism.

In addition, the Government made sweeping changes in the trade and incentive regime, taking a more favourable line on private investment, including foreign investment. It abolished the import licensing system, removed most domestic price controls and returned some nationalized enterprises to their previous owners. A new Foreign Investment Law, giving a 30-year guarantee of non-nationalization and compensation, was enacted in 1967. Indonesia rejoined the International Monetary Fund and the World Bank, which enabled it to receive substantial foreign assistance for its adjustment programme and to work out arrangements to reschedule its debt (World Bank, 1993b; Azis, 1994; Hill, 1992). Note that, during its initial stabilization and reform period in the 1960s, Indonesia benefited from a large amount of debt forgiveness and internationally sanctioned debt relief (James and Stephenson, 1994, p. 30).

Table I.5. Indonesia: Chronology of major economic events, 1965-1982

Year and Month	*Event*
1965	
December	"New" rupiah introduced, equivalent to 1,000 "old" rupiah; petroleum prices increased 250-fold; Indonesia ceased to meet foreign exchange commitments
1966	
March	Soeharto assumes formal executive authority
April	Indonesia applies for readmission to United Nations
June	Arrival of International Monetary Fund mission
September	First major meeting with non-communist creditors, in Tokyo
October	Major stabilization and rehabilitation programme announced; import licensing system partially dismantled; "export bonus" scheme liberalized
December	Further meeting with creditors, in Paris
1967	
January	New Foreign Investment Law announced
February	First official meeting of IGGI in The Hague
July	Major foreign exchange liberalization
August	Banking crisis
September	Widespread rice shortages reported
November	New mining law enacted
December	Major reorganization of state enterprises; new banking law introduced
1968	
April	Large increases in prices of petroleum products and utilities
May	Major overhaul of "export bonus" scheme
September	Positive rates on bank deposits instituted
November	Domestic investment law introduced
December	Eight commercial banks established
1969	
April	Repelita I commences; start of financial year shifted from 1 January to 1 April
May	Further reorganization of state enterprises

Table I.5. *(continued)*

Year and Month	*Event*
September	Ekonomi dan Keuangan (Indonesia's main economics journal) resumes publication
December	Inflation effectively brought under control (17 per cent for the year)
1970	
April	Major trade policy package: devaluation, elimination of most multiple exchange rates, simplification of export and import procedures; elimination of international capital controls; import bans on commercial vehicles and second-hand automobiles introduced
May	Bimas Gotong Royong discontinued, replaced with Bimas Nasional and Inmas
December	Final and complete unification of the exchange rate
1971	
April	Import ban on CBU automobiles imposed for Java and Sumatra
August	10 per cent devaluation of rupiah, now pegged to US$
September	Import duties on 459 items reduced
1972	
December	Serious rice shortage evident; rice prices doubled August-December
1973	
August	International petroleum prices begin to rise steeply, quadrupling in next six months
September	The Investment Coordinating Board (BKPM) established
November	Preferential treatment by state banks for small pribumi borrowers announced
1974	
January	Malari protests occur; import ban extended to all CBU vehicles; state bank medium-term credits henceforth available only to firms with significant pribumi-pribumi partners strongly encouraged, local equity to exceed 50 per cent within 10 years, more sectors closed to foreign investors (the regime was tightened further in March, July and September)
March	Regional development strategy announced, including establishment of Bappedas; state enterprises transferred from the Department of Finance to "technical" departments

Table I.5. *(continued)*

Year and Month	*Event*
April	Repelita II commences; anti-inflation package announced, including increased interest rates and ceilings on (state) commercial bank credit
1975	
February	Pertamina unable to repay or refinance its short-term debt
April	Major shift in sugar strategy announced, encouraging smallholder production
May	Bank Indonesia ceased publication of its weekly and monthly *Bulletin* (resumed September, 1976)
July	Soeharto and the Japanese Prime Minister sign the Asahan Agreement
October	Imports of 23 varieties of textiles banned
1976	
February	First ASEAN Summit held, in Bali
March	President Director of Pertamina, Ibnu Sutowo, "dismissed with honour"
April	Export promotion package introduced, most export taxes reduced to 5 per cent
August	Regulations relating to "third generation" mining contracts announced
1977	
February	Investment licensing regime becomes more transparent, with first official release by BKPM of Investment Priority List (DSP); petroleum investment incentive packages become more attractive
June	Government announces stepped-up anti-corruption campaign
August	Jakarta Stock Exchange re-opened; first major LNG shipment, from Bontang (East Kalimantan) to Japan
1978	
January	Deposit rates reduced, and banks' reserve requirements cut from 30 to 15 per cent
August	Smallholder development programme introduced, including Nucleus Estates Scheme and several crop-specific initiatives
November	50 per cent devaluation of the rupiah; extensive price controls introduced

Table I.5. *(continued)*

Year and Month	*Event*
1979	
January	Export Certificate (Sertifikat Ekspor) scheme introduced, as an incentive to exporters
April	New tax package introduced, affecting company, sales and excise taxes, and tariffs; Repelita III commences
September	Second round of large increases in international petroleum prices commences
October	Stage I of PT Krakatau Steel starts production
1980	
March	Presidential Decree 14A favours pribumi in government procurements
May	Ban on log exports announced, to be introduced in several phases; 50 per cent increase in domestic petroleum prices
July	Indonesia's first textile trade dispute, with the United Kingdom
1981	
November	Automotive industry plan envisages full local content by 1985
1982	
January	Domestic petroleum prices increased by 60 per cent, halving the budgeted oil subsidy; new trade promotion package announced, including counter purchase and export credits
March	Emergency OPEC meeting agrees to production cutbacks
November	Import licensing in the form of approved importer system (Tata Niaga Impor) commences; sharp increase in departure tax, from Rp 25,000 to Rp 150,000

Table I.6. Indonesia: summary of economic reforms, 1983-1990

Year and Month	*Reform*	*Impact*
a. Fiscal reforms		
1983-84	Postponement of large-scale and capital-intensive projects	Reduced pressures on government budget
	Reduction of subsidies on fuel and rice	
April 1984	Introduction of value added tax	Increased coverage, collection rates, and government revenues
	Rationalization of income tax	
	Additional 10 to 20 per cent tax on luxury goods	Reduced tax bargaining
	Removal of withholding tax	
	Improvement of tax administration and apparatus	
1986	Introduction of new property tax at a single rate of 0.5 per cent	Slight increase in property tax revenues
	Introduction of new law on stamp duties	Reduced number of transactions involving stamp duties
	Subsidy on fertilizers and pesticides reduced	Further reduction of pressures on government budget
	Efficiency of government agencies in implementing development projects increased	Increased efficiency
	Suspension of carrying unspent development funds over to next year (SLAP)	
1987	Further reductions in capital expenditure	Strong relief in budget constraints
	Restraints of subsidies and administrative cost	
b. Financial reforms		
March 1983	Devaluation of rupiah by 28 per cent	Improved export competitiveness
June 1983	Credit ceilings removed Interest rate controls removed	Rise in deposit rate Liquidity credit still increased
	Subsidized liquidity credit reduced	Fall in cost of intermediation
	SBI and SBPU introduced (see text)	
1983-84	Jakarta Stock Exchange activated	Trade in stocks occurs below par value
	Opening of bond market	

Table I.6. *(continued)*

Year and Month	*Reform*	*Impact*
1985	Capital Market Executive Board (BAPEPAM) initiates further reform and reduces requirement for new issues (to Rp 200 million)	Some commercial banks receive underwriting privileges for stock and bond issues
September 1986	Devaluation of rupiah by 31 per cent	Increased export competitiveness
October 1986	Ceiling on swaps removed	Increased swap trading
December 1987	Capital market deregulation	Increase in capital market activity
	Stock purchase allowed to foreigners	
	Establishment of a secondary over-the-counter market	
October 1988	Lending limit regulation	Many banks and joint ventures emerged
	Reserve requirement lowered	Intense competition between banks
	Licences for new banks and joint ventures	Interest rates soar
	More competition allowed between commercial and state banks	Signs of fall in interest rate spread
	Easier branching for existing domestic and foreign bank allowed	
November 1988	Reform of the currency market rate	More market-based swap
December 1988	Deregulation of insurance industry	Significant increase in market activity
	Further capital market deregulation	Increased market index
	Rationalization of financial services sector (including foreign)	Many companies going public
c. Trade reforms		
March 1985	Reduction in number of tariff levels	Increased efficiency and import flows
	Reduction in tariff ceiling	
April 1985	Swiss survey firm assigned to manage customs	Early positive psychological effects
	Port charges reduced	Reduced inefficiencies in shipping, port handling, and customs procedures

Table I.6. *(continued)*

Year and Month	*Reform*	*Impact*
	Shipping industry opened to international competition	Increased export competitiveness
	Port administration simplified	
May 1986	Introduction of duty drawback system to "producer-exporters"	Clear signs of export increase along with augmented foreign investments
October 1986	Import licensing reduced	Further increase in export-oriented investments
	Tariffication	Increase in necessary (nonconsumption) imports
	Further tariff reduction	
January 1987	Further reduction in import licensing	Same is in October 1986
July 1987	Still further reduction in import licensing with no tariff increase	
	System of textile quota allocation improved	
November 1988	Inter-island shipping deregulated	Increased competition
	Removal of monopolies in imports of steel and plastic	Increased confidence in government efforts to deregulate the economy
May 1990	Deregulation in pharmaceuticals and animal husbandry	Increased competition
	Adjustment in tariffs	Improved investment climate
	Reduction in number of surcharges Further removal of non-tariff barriers	
d. Investment reforms		
1985	Simplification of application procedures for foreign investment	Reduction in waiting period and number of documents
May 1986	Allowance of 95 per cent foreign ownership in export-oriented investments	Increased exports and number of documents
	Local distribution opened to export-oriented firms	Japanese department store "Sogo" opened
	Export credit scheme opened for participation by joint ventures	Increased confidence in the economy
	Retail trade opened to foreign firms	

Table I.6. *(continued)*

Year and Month	*Reform*	*Impact*
1986	One-year tax exemption on imported equipment	Enthusiastic response from foreign investors
	Visa requirements from 29 countries lifted	
	Investment from Eastern European countries no longer needs intelligence approval	
September 1986	Maxi devaluation (more than 30 per cent)	Increased export competitiveness
	Deregulation of investment and capacity licensing	Improved investment climate
	Stock exchange opened to foreign investors	
November 1988	Further deregulation in shipping industry	Increased investment climate
	Joint ventures allowed to distribute their own products domestically	
May 1989	Replacement of priority list with negative list	Improved investment climate further
June 1989	Attempts to improve efficiency of state enterprises	Some state enterprises showed improved efficiency
	Encourage privatization	Increased signs of more "going public"
1989	Foreign portfolio investors allowed to purchase 49 per cent of nonbank companies listed on stock exchanges	Improved foreign confidence in the economy
November 1989	Steps to improve performance of state enterprises	186 out 210 state enterprises affected
	Specific steps to improve efficiency in 75 enterprises	Sales of equity in 52 state enterprises
1990	Up to 30 per cent of shares of three large state cement enterprises offered public	Increased expectation of further privatization

Source: Iwan J. Azis, 1994. Indonesia, in John Williamson, ed., *The Political Economy of Policy Reform*, Washington, DC, Institute for International Economics, pp. 394-397.

The outcomes of the above reforms (stabilization and adjustment) were quite dramatic in restoring macroeconomic stability and spurring recovery. The inflation rate dropped from 595 per cent in 1965 to less than 115 per cent in 1967 and plunged further to double digit rates in 1969 (17 per cent) and 1973 (19 per cent). Also, the external accounts were brought into balance.

Having achieved these stabilization goals, the Government addressed longer-term goals through the first five-year development plans, which stressed agricultural and rural development, improvement in social conditions, human resource development, infrastructure, and industry support of agricultural production.

During the period 1973-1981, less macroeconomic policy adjustment was undertaken by the Government compared to the episode of the 1960s. In fact, during this period, Indonesia achieved rapid and sustained economic growth. Real GDP increased at an annual average rate of 7.7 per cent. This remarkable achievement was the result, in particular, of the oil booms as well as the boom in other commodity prices. Net oil and liquefied natural gas (LNG) earnings rose from $600 million in 1973/74 to a peak of $10.6 billion in 1980/81. Oil and LNG earning accounted for 75 per cent of export earnings and 70 per cent of budget revenue.

Revenue from the oil boom contributed to the reduction of poverty, improvements in living standards and the expansion of infrastructure. The Government also did much through its heavy spending on agriculture (especially in rice) and rural infrastructure, including improvements in the availability of education, health and family planning services.

However, it should be noted that during this oil boom period there was also extraordinary economic turbulence; some difficulties were self-inflicted but most were exogenous in nature. A poor rice harvest domestically and abroad resulted in serious rice shortages in 1972 and a doubling of rice prices. In addition, the windfall gain from international oil prices also posed the familiar "Dutch disease" problem and significant inflationary pressures.

High international oil prices also resulted in the resurgence of a nationalist economic agenda. Over this period, official policy strongly favoured "pribumi" (local people) business interest, trade and foreign investment policies became more restrictive, and new plans for an expanded state enterprise sector were announced.

Towards the end of the decade of the 1970s, policy-makers became increasingly concerned at the prospect of declining oil prices. Consequently, a large devaluation occurred in November 1978, not for the usual balance-of-payment reasons but to restore the competitiveness of non-oil tradeable sectors in preparation for an anticipated softening in world oil prices. In the event, this softening in world oil prices did not occur for another four years. In 1979, the Iran-Iraq war precipitated another round of large oil price increases, thus rendering the devaluation largely irrelevant.

The windfall gain from oil, however, did not last. Between 1982 and 1988, Indonesia experienced major external shocks from three main sources: (a) the worldwide recession, which adversely affected the prices of and demand for traditional Indonesian exports (mainly agricultural products, such as rubber and palm oil); (b) a sharp decline in the external terms of trade, largely due to the oil price collapse from a peak of $34 per barrel in 1981 to below $13 per barrel in 1986; and (c) the depreciation of the United States dollar vis-à-vis major currencies in 1985-1988, which added substantially to Indonesia's external debt burden.

In response to these crises, the Government adopted and implemented a structural adjustment programme which covered four broad categories of measures relating to: (a) exchange rate management, (b) fiscal policy, (c) monetary and financial policies, and (d) trade policy and other regulatory reforms.

With regard to exchange rate management, Indonesia resorted to currency devaluation twice during the period. In March 1983, the rupiah was devalued by 28 per cent and full currency convertibility was established. This was primarily aimed at closing the large current account deficit. The rupiah was again devalued by 31 per cent in September 1986 in direct response to the rapid decline in oil prices and to improve the competitiveness of the non-oil economy. Indonesia changed to a managed float system after the 1978 devaluation but the float was applied actively only from 1988.

With regard to its fiscal policy, the Government in the 1980s undertook major changes in the level and pattern of expenditure and revenue. On the expenditure side, a major budget retrenchment effort was made. As part of the package, current expenditure on education, health and other wages and salaries were cut relatively less than subsidies and capital expenditure on investment projects in the various sectors. Several large public investment programmes were cancelled or postponed, while smaller labour-intensive projects under the regional development INPRES (Presidential Instruction) programmes were encouraged. At the same time, the Government encouraged savings through comprehensive financial and tax reform, and made major efficiency improvements in customs, ports and shipping.

Trade policy and other regulatory reforms were also adopted. These measures included tariff reductions across the board, import restrictions were lifted from a wide range of products, and other major regulatory reforms relating to the treatment of investment were carried out. See Thee (1994), Hill (1992), Bhattacharya and Pangestu (1993) and Azis (1994) for details on policy measures and the outcomes of these structural adjustment measures.

2. *Financial reforms*

In terms of financial resource mobilization, the New Order Government under Soeharto changed the financial market and policies from extreme intervention to a more market-oriented approach. In 1967, the Government permitted private and foreign banks to operate in Indonesia, though under strict control. Further, in March 1983 a major reform of the banking system was undertaken requiring banks to follow market principles in attracting deposits and allocating credit. Limits on both deposit rates and lending rates were removed, sectoral credit ceilings were lifted, and subsidized liquidity credits were abandoned. This was complemented by the exclusion of interest income earned on bank deposits from tax liability and by establishing a market for corporate bonds.

There was also the first shift to open-market operations, with the development of new monetary policy instruments. These included Central Bank certificates (Sertifikat Bank Indonesia) which were introduced in February 1984 and designed to mop up excess liquidity, and a short-term debt facility (Surat Berharga Pasar Uang) introduced in February 1985 as a means of injecting short-term liquidity when required (Hill, 1992).

However, the implementation of these reforms remained patchy and sporadic and the Government still lacked the instruments to deal with the consequences of an open international capital market. Consequently, in October and December 1988, a decisive financial policy initiative was introduced. These financial measures were aimed at encouraging the development of the capital market and strengthening the financial sector by increasing competition. All domestic banks were free to open new offices and new private banks were permitted.

In addition, foreign banks were allowed to operate outside Jakarta subject to certain conditions: non-bank state enterprises were permitted deposits of up to 50 per cent of their funds with private (national) banks, reserve requirements for commercial banks were cut from 15 to 2 per cent of their liabilities, a 15 per cent tax on bank deposits was introduced, primarily to stimulate the stock market, and monetary policy instruments and the swap on foreign borrowings were fine-tuned. These reforms led Indonesia to experience a private sector banking boom as these institutions began to compete aggressively for customers and market share.

In 1992, another financial policy was introduced. In this year, the new banking law laid down that there were to be no more specialized banks, except for general banks and people's banks. People's banks were not allowed to provide demand deposits or participate in the clearing process and foreign exchange services. Foreigners could now purchase bank shares. The legal status of state banks was changed to that of a limited liability company, to allow them more autonomy and to be managed as a private corporation. In October 1992, the capital requirements to set up domestic and joint venture banks were raised by five times for the former and by double for the latter. This move appeared to have been motivated by the desire to limit the number of new banks. Liquidity credits were also reduced as from April 1990, a change related to the deadline given by the General Agreement on Tariffs and Trade to Indonesia to remove the subsidized export credit scheme by April 1991 (World Bank, 1993b; Bhattacharya and Pangestu, 1993).

3. *Institutional reforms*

Institutional capacities in Indonesia have a major bearing on the effectiveness with which economic policy reforms are implemented. The Government has undertaken institutional development and reform by evolving the role of the public sector. These measures include: (a) strengthening the legal, judicial and accounting institutions underpinning markets to foster efficiency, transparency and wide participation in private sector development, (b) reforming public enterprises by implementing an appropriately designed programme of divestiture of enterprises engaged in the provision of private goods and by commercializing as much as possible the operations of those that need to remain public, (c) reassessing and realigning government administrative structures and skills and incentives of the civil service, to adapt them to the changing focus of government functions and to improve the quality of governance, (d) improving the efficiency and equity of public service delivery by decentralizing responsibilities to local governments and reforming central-local fiscal relations, supported by an enhancement of local government institutional capacities, and (e) building institutional capabilities for environmental management at the central and local levels, including promoting effective participation of local communities.

With regard to institutional underpinnings of markets, the Government provides a legal system to provide a predictable and fair environment for business, and a sound accounting and auditing system to instil financial discipline. Similarly, with regard to public enterprise reform, the Government undertook a commercialization of enterprises providing public goods and services that needed to remain in the public domain, and a gradual divestiture of enterprises providing private goods and services. Also, a Presidential Decree in 1988 launched an assessment of the financial soundness of each public enterprise and the development of a programme for their restructuring. The proposed measures varied from a change in legal status (for example, from Perum to Persero), mergers, management contracts, joint ventures, public share issues, to liquidations. The Government also introduced a system to monitor enterprise financial performance annually, based on an evaluation of the firm's profitability, liquidity and solvency.

In terms of the public administration and civil service, the Government undertook extensive deregulation and de-bureaucratization in order to deal with the major structural changes under way in the economy. These measures were aimed at ensuring not only that the Indonesian people received the full benefit of public services, but also that it provided an environment that would induce private business to be efficient and provide goods to domestic consumers and export markets at competitive prices, and that would attract both Indonesian and foreign investors.

Finally, a significant institutional framework for environmental management was introduced in Indonesia over the past decade or so. The main institution is the Environment Ministry charged with policy formulation, coordination and oversight responsibilities in environmental protection. During much of the 1980s, the Environment Ministry focused on putting in place the essential elements of a strategy for sustainable development, including laws and regulations, and a support network of environmental organizations.

4. Regional economic cooperation

Regional economic cooperation is another area where a marked shift in economic policies and priorities occurred after 1966. During the first half of the 1960s, Indonesia was disengaging steadily from the international economy. Since 1966, Indonesia has widened its regional economic cooperation with the Association of South East Asian Nations (ASEAN), Japan, The United States, Canada, the NIEs (Hong Kong, Republic of Korea, Singapore and Taiwan Province of China), and the Asia Pacific Economic Cooperation (APEC).

The rationale for regional cooperation with ASEAN is not premised on economic considerations alone but also on political, security and cultural objectives. But, as far as the economic justification is concerned, ASEAN, like other regional groupings, was supposed to widen the market for industries of the region and thereby enable them to achieve economies of scale and to increase efficiency through greater specialization.

The rapid increase in Indonesia's foreign trade has been accompanied by an equally rapid increase in foreign direct investment. Japan and the Asian NIEs became the most important source countries for foreign direct investment (FDI) in Indonesia. The policies to attract new FDI included fiscal incentives and investment guarantees to foreign investors.

In recent years, in the face of increasingly sharp competition from other Asian developing countries to attract foreign investment (notably from China and to a lesser extent from Viet Nam as well as the other ASEAN countries), the Government has been forced to introduce further reforms in its foreign investment regime. These reforms have included further reductions in the negative list of fields, which had previously been closed to foreign investment, and less stringent conditions governing the divestment of foreign investment projects to minority share-holding, Other modifications, which in the past were deemed impossible in view of political constraints, such as allowing fully-owned foreign investment projects for projects in excess of $50 million, a simplification of the approval process for projects, and cutting out the involvement of provincial authorities were also adopted. Table I.5 shows the growth of investment approvals in Indonesia from 1967 to May 1994.

As can be seen from table I.7, both domestic and foreign investment in Indonesia have, in general, tended to increase during the periods of relatively liberal policies towards investment (the late 1960s and the late 1980s) and to decrease during periods of more restrictive policies (late 1970s and early 1980s). There are, of course, many factors that have influenced the extent to which investment has flowed into Indonesia; these include the economic conditions in Indonesia (buoyant or depressed), home country conditions and the relative attractiveness of other potential host countries. The steep increase in foreign investment since 1986 does reflect the effects of the improvement in the investment climate caused by the successive deregulation measures, although home country factors, such as the steep appreciation of the Japanese yen, the Korean won, and the new Taiwan Province of China dollar after 1985, and rapidly rising wage rates and land costs in these countries, have played an important role.

5. Other non-economic factors

Apart from the above economic factors, non-economic factors are unquestionably critical in explaining Indonesia's development success. Various non-economic factors such as the continuity of leadership, the role of technocrats, bureaucrats, the armed forces, the political party, and public consensus have been identified (Azis, 1994).

A continuity in leadership under Soeharto has been extremely important, if not crucial, in maintaining the sustainability and continuity of the economic reform process. Also, the way in which the Government or the bureaucracy supported markets and fashioned an institutional framework for effective policy implementation is as critical as the policies themselves. This is because if better government does not accompany the economic reforms, the reform policies themselves will not succeed.

The strong commitment of the government to the development of agriculture, the allocation of sufficient budgetary and human resources to extend primary education throughout the countryside, and the ongoing programmes aimed at boosting health and family planning all provided a fundamental basis for success when the reforms to open the economy began in earnest. Getting the fundamentals right during the last quarter of a century allowed a strong supply response to incentives, technological innovations in agriculture, the exchange rate and, later, through the reforms of trade and investment policies.

Further, the presence of skilled economic technocrats, who were often placed in positions in Government, was a major factor in the success

Table I.7. Indonesia: growth of investment approvals, 1967-May 1994

Year	*Domestic investment*		*Foreign investment*	
	Project	*Value (Rp billion)*	*Project*	*Value ($million)*
1967	–	–	12	207.1
1968	26	38.0	35	264.4
1969	73	33.5	37	127.5
1970	176	112.6	83	166.8
1971	214	185.9	62	287.2
1972	268	185.9	47	163.0
1973	299	469.3	69	323.8
1974	134	170.2	53	542.4
1975	78	158.5	24	1,145.0
1976	75	22.4	22	221.0
1977	155	483.6	20	167.0
1978	188	678.8	23	207.1
1979	166	654.8	13	248.6
1980	159	2,817.3	20	1,074.4
1981	164	2,291.8	24	706.5
1982	205	3,616.0	31	2,416.9
1983	333	6,476.0	46	2,470.8
1984	145	2,109.0	23	1,096.9
1985	245	3,736.2	45	853.2
1986	315	4,411.5	93	847.6
1987	570	10,449.6	130	1,520.3
1988	843	14,201.8	145	4,410.7
1989	863	19,593.8	294	4,713.5
1990	1,324	56,510.5	432	8,751.1
1991	804	41,077.9	376	8,778.0
1992	436	29,341.7	305	10,323.2
1993	548	39,450.4	329	8,144.2
1994	314	22,750.7	131	5,019.4

Source: Investment Coordinating Board, Jakarta.

Notes: The data excludes foreign investment in oil, banking, insurance, and leasing. The data refer to new projects only. The amount of investment includes the approved amount for new projects, as well as the approved expansion of existing projects.

of reforms. The team of technocrats evaluated the options and arrived at a common, coherent view on the next step in policy reforms. Moreover, their approach was pragmatic, professionally based and was little influenced by party politics and ideology. Although special interest groups have been able to influence policy decisions and rules in their own favour, the degree to which this has occurred has not been serious enough to prevent overall growth and development. Azis (1994) points out that the technocrats have had the continuous backing of the President, especially for the implementation of difficult policy decisions.

Finally, macroeconomic stability has been maintained in Indonesia throughout the reform process. Overall, the economic technocrats have shown a flexible approach to policy reform, implementing change when necessary (such as with the major reform package adopted in response to the collapse in the oil price) and correcting for errors in policy direction (such as the exchange rate value) in a flexible and timely manner. These corrections, along with respect for the fiscal constraint imposed by the balanced budget law, have meant that the macroeconomic basis for reforms has remained solid.

E. INDO-CHINESE ECONOMIES: PROFILES, POLICY REFORMS, ACHIEVEMENTS, PROBLEMS AND PROSPECTS

The above section examined some of the main factors for Indonesia's success in economic development since 1965. In this section, we provide a profile of the Indo-Chinese economies and discuss their ongoing economic policy reforms, recent developments and problems. This will serve as the background against which we will consider whether Indonesia's experience can be applied to the Indo-Chinese countries.

1. Profile of the Indo-Chinese economies

What is the economic profile of the Indo-Chinese economies? The profile of the Indo-Chinese economies is almost similar to that of the Indonesian economy, particularly in terms of natural resource endowments. In the Indo-Chinese countries, agriculture has been the main source of income of the population. In Viet Nam, for instance, in 1990, approximately 71 per cent of the labour force was engaged in agricultural production, 14 per cent in construction and industry and the remaining 15 per cent in other activities, including services.

Agriculture and forestry play a dominant role in the economy, accounting for 65 per cent of employment, 45 per cent of national income and 55 per cent of exports (including marine products). Rice represents the main crop, accounting for about 50 per cent of agricultural output and 85 per cent of food grains output. Other agricultural products of importance include maize, potatoes, cassava, rubber, coffee, tea, coconut and pepper. However, the relative importance of forestry has declined sharply in recent years as a result of excessive deforestation in the past, which has reduced the forest cover from 14 million hectares in the 1940s to about 8 million hectares today (Ariff, 1994).

In the Lao People's Democratic Republic, in 1990, 80 per cent of the population depended on agriculture, mainly subsistence farming, for their levelihood. Public services and state-owned industries absorbed about 15 per cent of the working population, while other manufacturing activities employed a meagre 1.5 per cent. It appears that the hidden, informal economy also sustains many households.

The main agricultural crops in the Lao People's Democratic Republic, apart from rice, are maize, coffee, cassava, peanuts and tobacco. Timber is also important in the economy. Among the major timber species found are redwood, mahogany, ironwood, teak and pine. However, of the total land area, only about 8 per cent, or 1.8 million hectares, is cultivable, and only 900,000 hectares, or 3.8 per cent of the total land area, are currently under cultivation. Commercial logging, both legal and illegal, has depleted the forest cover, especially in some northern provinces of the country, down to as low as 20-30 per cent of the land area.

Like Viet Nam and the Lao People's Democratic Republic, Cambodia is also rich in natural resources, particularly agricultural and forest resources. However, only 60 per cent of its 2.5 million hectares of arable land and 630,000 hectares of pasture land are utilized. Forest resources are now deteriorating as a result of reckless deforestation. The share of the labour force engaged in the agricultural sector was about 80 per cent in 1990. Agriculture contributed about 61 per cent of GNP in 1990, while industry and commerce accounted for 12 and 11 per cent of GNP respectively. Manufacturing is confined to light industrial activities. In 1990 there were about 1,470 rice mills in rural areas and approximately 70 factories in urban areas producing household goods, textiles, soft drinks, alcohol and jute sacks.

Apart from agricultural and forest resources, the Indo-Chinese countries have substantial mineral deposits and oil reserves. In Viet Nam, for example, coal deposits total about 20 billion tons, iron ore reserves are estimated to be about 700 million tons, and there are an estimated one billion tons of apatite (used in the manufacture fertilizer). Other minerals of considerable commercial importance include manganese and titanium ore, chromite, bauxite, tin, copper, zinc, lead, nickel, graphite and mica. A small quantity of gold is also found.

In the Lao People's Democratic Republic there is a variety of mineral resources but only a few are currently exploited, notably gypsum and tin. Oil and gas explorations are being undertaken by a British-French consortium in Savannaket province, and by Hunt Oil in Saravan and Champassak provinces.

Cambodia, however, is not endowed with many mineral resources. There are limited deposits of limestone, kaoline, tin, bauxite, gold, silver and iron ore, but these are not exploited on a commercial basis. Phosphates are used in the production of fertilizers. Off-shore oil and gas reserves are said to exist, but they have yet to be explored. Gems (sapphires and rubies) are found in large quantities in Batambang province (Vo and Booth, 1992; Ariff, 1994).

The main exports of the Indo-Chinese countries are varied. Viet Nam exports light industrial products and handicrafts, heavy industrial products and minerals, agricultural products, marine products and forest products. Viet Nam's imports consist largely of producer goods (for example, fuel and raw materials). In 1990, producer goods accounted for 85.1 per cent, whereas consumer goods accounted for only 14.9 per cent of the total imports. The primary sources of imports for Viet Nam are Singapore, Japan and Hong Kong, with Singapore the largest source of imports.

Timber and electricity are the principal exports of the Lao People's Democratic Republic. Exports of timber and wood products have grown rapidly since 1986, accounting for over 43 per cent of total exports in 1991, but a logging ban was introduced in August 1991. Electricity exports accounted for some 40 to 50 per cent of total exports in the early 1980s and as much as 70 to 80 per cent of hard currency exports in some years. However, in 1987 and 1988, electricity exports fell drastically because of drought conditions but have subsequently recovered, contributing over 80 per cent of total exports in 1991. Coffee is the third most important export commodity, although its contribution to export earnings is far less significant compared with timber or electricity.

Most of the trade of the Lao People's Democratic Republic is with Thailand, which is not surprising given its geographical proximity and lack of access to sea routes. Exports to the former Soviet bloc, consisting mainly of gypsum, tin and coffee, have declined drastically. Imports, comprising mostly machinery, building materials and goods, are sourced mainly from Thailand, Singapore and Japan (Ariff, 1994; Vo and Booth, 1992).

In Cambodia, the main exports are crêpe rubber, unprocessed timber, red maize, soybeans, sesame, and tobacco. Cambodia's trade with the convertible currency zone and with the non-Soviet members of the Council of Mutual Economic Assistance (CMEA) is roughly in balance, but its trade with the former Soviet Union up to 1990 has consistently shown a large deficit. Since 1986, there has been a growing informal and quasi-official trade with Thailand and Singapore.

Although these three economies, Viet Nam, the Lao People's Democratic Republic and Cambodia, are amply endowed with natural resources, they are still among the least developed countries with per capita incomes of not more than $200 in 1990. However, the economic performance in Viet Nam is better than in the other two countries. In Viet Nam, the economy grew at the average annual rate of 6 per cent during the period 1975-1982, slowed down between 1982 and 1985, and declined markedly in 1986 and 1987. Since 1988, the economy has been growing somewhat steadily at the rate of about 5 per cent per annum. In addition, Viet Nam, although having suffered through many years of war and its aftermath, managed to become a rice exporter in 1990.

2. *Policy reforms and economic achievements*

(a) Economic policy reforms

In the 1980s, the Governments of the Indo-Chinese countries initiated a major shift in their strategy of economic development away from central planning towards the market economy. To achieve their development objectives, these countries have initiated economic policy reforms. Viet Nam, for instance, under the banner of *Doi Moi* (renovation) emphasized five kinds of economic policy reforms, namely, (a) structural readjustment of the national economy, and consequently of investment policy, (b) promotion of a multi-sectoral economy, (c) an overhaul of the mechanisms of economic management, (d) reorganization of the state administration and the legal system and (e) diversification of Viet Nam's external economic relations.

The policy measures within the programme of reforms include the end of the collective system in agriculture (reforms in agriculture), participation of private enterprises in all economic sectors, recognition of private initiatives in corporate decisions, flotation of the exchange rate, monetary measures to free interest rates, budgetary measures to eliminate subsidies in production and consumption, privatization of state-owned enterprises (SOEs), establishment of export processing zones, liberal investment policies, offering tax holidays and 100 per cent equity, to encourage the inflow of foreign direct investment. See Vo and Booth (1992) for details.

Similarly, in the Lao People's Democratic Republic, the Government has embarked, since 1985, on a comprehensive programme of policy reforms, branded the New Economic Mechanism, aimed at transforming the economy from a centrally planned to a marked-based economy. The economic reforms of the Lao People's Democratic Republic have paved the way for market-determined prices, trade liberalization, elimination of subsidies, free market exchange rates, prudent budgetary policies, private sector participation in production and distribution of goods and services, and liberal policies towards foreign direct investment (Ariff, 1994).

In Cambodia, market-oriented economic restructuring was initiated in 1985, but these reforms did not take off until 1988. The policy reforms included the removal of price controls for all commodities (except for a few items like electricity and fertilizer), a realignment of the exchange rate with the parallel market rate, restoration of private property rights, and rationalization of SOEs with greater autonomy and privatization. The measures also encouraged joint ventures and fully foreign-owned enterprises, allowed foreign banks to operate in the country, removed many restrictions on trade and enabled macroeconomic adjustments.

(b) Economic achievements

The impact of economic policy reforms on the development of the Indo-Chinese countries has been impressive. The average GDP growth in Viet Nam, for instance, during the period 1986-1991 was 5.2 per cent. Economic growth in the Lao People's Democratic Republic increased remarkably from -1.8 per cent in 1988 to 4 per cent in 1991. Similarly, economic growth in Cambodia was high at an average of 8 per cent during the period 1988-1991. Another marked achievement of macroeconomic stability was the dramatic reduction in inflation. Inflation in Viet Nam was reduced from 775 per cent in 1986 to 20 per cent in 1992 while the Lao People's Democratic Republic brought down its inflation rate from 76 per cent in 1989 to 10 per cent in 1991.

Tax reforms, expenditure restraints and privatization of SOEs have introduced new budgetary discipline. The relative share of tax revenue and transfer from SOEs in Viet Nam has increased from 18.75 per cent in 1987 to 34.37 per cent in 1990, and the budget deficit was reduced from 8.5 per cent of GDP in 1989 to 3.9 per cent in 1990. However, in the Lao People's Democratic Republic and Cambodia, the budgetary deficit as a percentage of total expenditure has remained high at 60 and 45 per cent respectively.

The export performance of the Indo-China countries has improved significantly in recent years. Since 1989, Viet Nam has emerged as the third largest exporter of rice after Thailand and the United States. In addition, for the first time, Viet Nam registered a trade surplus during the first nine months of 1992. There was also a 7.4-fold increase in the share of exports to Asian markets between 1986 and 1991, with Asian markets absorbing about two thirds of total exports from Viet Nam. In the case of the Lao People's Democratic Republic, however, export earnings of about $100 million per annum cover only one third of its imports, with the deficits amounting to 10 per cent of GDP.

Foreign direct investment has also increased in all three countries. By mid-1992, the bulk of foreign investment in Viet Nam had gone into industry (33 per cent), oil and gas (27 per cent) and hotel and services (25 per cent). In the Loa People's Democratic Republic, FDI from 25 countries, involving 256 projects with an aggregate value of $448 million, was approved between 1988 and 1992. In Cambodia, some 480 FDI projects were approved up to 1992, with foreign investments during 1991 and 1992 totalling about $800 million.

Finally, in terms of social indicators such as life expectancy and educational attainment, the human development index published by UNDP in 1991 estimated that, in 1989, life expectancy at birth in Viet Nam was 62.7 years, which was about the same as in Indonesia, and higher than India (59.1 years) or Bangladesh (51.8 years). Viet Nam also scored higher on the UNDP educational attainment index than Indonesia, Myanmar or Pakistan (or indeed countries such as Turkey, the Syrian Arab Republic and Iraq, where GDP per capita was above $1,000). In terms of gender disparity in education and in labour force participation, Viet Nam also scores rather better than Indonesia, and much higher than countries of South and West Asia and Africa. While doubt must remain about the quality of education, there can be little doubt that the quantitative achievement has been impressive.

3. Recent Indo-Chinese economic problems and prospects

Despite the recent impressive economic achievements in the Indo-Chinese countries, the problems faced by these economies are still enormous and there is need for continuing efforts to carry out further reforms. In the case of Viet Nam, for example, a resolution of the eighth National Assembly (December 1990), as quoted in Vo and Booth (1992, p. 31) acknowledged that:

> the 1990 socio-economic situation was more than difficult and complicated than before.... Our country's economic situation still has a serious imbalance. Both Gross Social Product and National Income still remain low. A large number of state and collective.... enterprises still experience many difficulties. Some of them even face the danger of bankruptcy. The state budget still displays a major deficit. The management of money and credit is still full of shortcomings. Market prices have not been stabilized yet. The unemployment rate is still on the rise. Cadres, civil servants, soldiers, retirees.... and ethnic minorities still experience many difficulties in their daily life.

Similarly, in terms of trade and foreign economic policy, recent analyses stress that much more must be done before the country can achieve the same success in export-led growth as economies such as the Republic of Korea, Taiwan Province of China, Thailand and Malaysia. The dong has been allowed to float since 1989, but little progress was made towards establishing a formal foreign exchange market until 1991. Although the floating of the dong was accompanied by substantial trade liberalization, reports abound of the complex maze of bureaucratic restrictions on both internal and external trade which business people must deal with. Quantitative controls on exports and imports are still widely used. Many investors find that they are subjected to high rates of "informal taxation" through, for example, the labour-hiring regulations which compel them to pay inflated wages to workers, most of which are then retained by the Government (Vo and Booth, 1992).

Much remains to be done on the attainment of the goal of restructuring the economy to emphasize the production of foodstuffs (agriculture), light industrial goods and exports. These problems are compounded by infrastructural bottlenecks and shortage of skilled manpower. The difficulties still encountered at present and in the immediate future in Viet Nam are shortage of electricity in the southern provinces, especially in Ho Chi Minh city, insufficient markets for exports of traditional goods such as agricultural produce, garments, handicrafts and art articles, the low purchasing power of the majority of the rural population, budgetary deficits and shortage of jobs.

The legal framework is incomplete, particularly with respect to property rights. In addition, privatization of SOEs has been slow in Viet Nam, as well as in the Lao People's Democratic Republic and Cambodia, where it has largely taken the form of leasing rather than outright sale. The remaining SOEs are in deep trouble without government subsidies and concessional loans (Ariff, 1994).

In short, while it could be said that the Indo-Chinese economies have undergone a change for the better with the introduction of economic policy reforms, the problems facing them are still great indeed. The growth rate is not yet quite as stable as could be wished for and there are still hindrances to the process of economic growth. The domestic market is still far from able to link directly to the world market. Business entities belonging to the nationalized sectors, for example, are still receiving a large amount of subsidy and protection from the pricing system that operates to their advantage.

However, this situation does not necessarily mean that there is basis for much pessimism. The prospects seem much brighter than those faced by other economies in transitions, especially the countries in Eastern Europe. Unlike the countries in Eastern Europe, the Indo-Chinese economies are essentially agricultural without being dominated by state-owned heavy industry. Besides, the role of the State was far less pervasive, in terms of rigid controls on production, in Indo-China than was the case in Eastern Europe, and the market legacy remained alive in some parts of the Indo-Chinese peninsula, in spite of communism. In addition, the Indo-Chinese countries have good opportunities for closer economic ties with the countries in the South-East Asian region, in particular, and with the world economy, in general.

F. CAN INDONESIA'S EXPERIENCES BE APPLIED BY THE INDO-CHINESE COUNTRIES?

What then can the Indo-Chinese countries do to improve their economic development? Should the Governments of the Indo-Chinese countries try to replicate the economic policy reforms undertaken in Indonesia or some other East Asian country? If so, what kind of economic policies from these neighbouring countries (particularly from Indonesia) are relevant for the Indo-Chinese economies? If not, what then should be the economic policy reforms which the Governments of the Indo-Chinese countries should follow?

1. Some possible lessons from Indonesia

Many lessons from the development experience of Indonesia can be learned by the countries of Indo-China. These lessons can be divided into three groups: economic reforms, social reforms, and political and institutional reforms. These reforms are related to each other in order to achieve stability, growth and equity.

In terms of economic reforms, the Indonesian Government has pursued fundamental economic policy reforms. These reforms encompassed macroeconomic stabilization, regional economic development, rural development, agricultural development, industrialization, finance, money and banking, trade policy and other external economic relations aimed particularly at achieving rapid and sustained economic growth.

Strategies to increase productivity growth, including absorbing of foreign technology, employment of selective industrial policies, and encouragement of rapid export growth have been by far the most generally successful selective approaches used by Indonesia. To absorb foreign technology, Indonesia actively sought foreign technology through a variety of mechanisms and welcomed technology transfers in the form of licensing, capital goods imports, and foreign training.

In addition, the active promotion of manufactured exports was a significant source of Indonesia's rapid productivity improvement. The Government gradually, but continuously liberalized the trade regime, while providing institutional support for exporters, to achieve its export push. Exchange rate policies in Indonesia were liberalized and the currency was frequently devalued to support export growth.

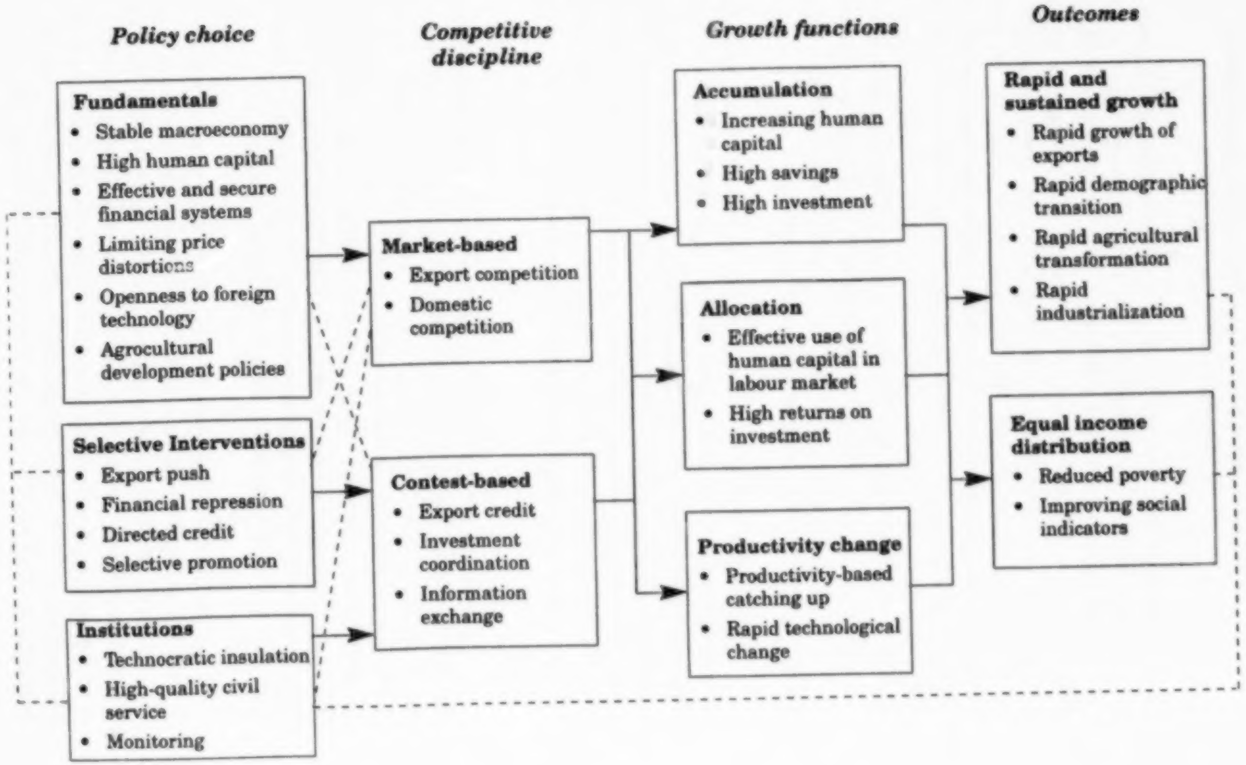
In the wake of the above economic policy reforms, the Government increased human capital investment, limited population pressure, and improved other social aspects of development. The Government, for example, provided elementary school and health facilities in almost all villages in the country. Similarly, family planning and transmigration programmes were introduced in the country. In the mid-1980s, for instance, Indonesia devoted more than 80 per cent of its education budget to basic education.

However, high levels of physical and human capital are not a guarantee for success. Resources, once accumulated, have to be allocated to high-yielding activities. For this purpose, the Government used a combination of market mechanism and government intervention to guide allocative decisions in both labour and capital markets. Labour market policies tended to use the market and reinforce its flexibility. In the capital market, the Government intervened systematically both to control the interest rate and to direct credit and subsidy to agriculture and small and medium-sized enterprises in the country.

In terms of political and institutional reforms, the Government convinced economic elites to support growth policies. The Government built a business-friendly environment in which a major element was a legal and regulatory structure that was generally hospitable to private and foreign investments. Also, the Government persuaded the elites to share the benefits of growth with the middle class and the poor. For example, Indonesia used rice and fertilizer policies to raise rural incomes. Details of the functional approach to growth in Indonesia are exhibited in figure I.1.

In summing up, the success of economic development in Indonesia has been the result of the positive role of the Government in charting a development course, the policies that the government adopted and the institutional mechanisms. While such lessons from the Indonesian economic development experience might be learned by the Indo-Chinese countries, one however cannot simply suggest that Indonesia's policy experiences are the best model for the Indo-Chinese countries to achieve success in economic development. This is because the problems that Indonesia and the Indo-Chinese countries encounter and the prospects that they face are somewhat different. The only things that one can recommend are that the Indo-Chinese countries should continue to pursue their market-oriented economic policies, emphasize the positive role of the Government in charting a development course, and fashion an institutional framework for effective policy implementation.

Figure I.1 Indonesia: a functional approach to growth


Policy choice
Competitive discipline
Growth functions
Outcomes
Fundamentals
• Stable macroeconomy
• High human capital
• Effective and secure financial systems
• Limiting price distortions
• Openness to foreign technology
• Agrocultural development policies
Selective Interventions
• Export push
• Financial repression
• Directed credit
• Selective promotion
Institutions
• Technocratic insulation
• High-quality civil service
• Monitoring
Market-based
• Export competition
• Domestic competition
Contest-based
• Export credit
• Investment coordination
• Information exchange
Accumulation
• Increasing human capital
• High savings
• High investment
Allocation
• Effective use of human capital in labour market
• High returns on investment
Productivity change
• Productivity-based catching up
• Rapid technological change
Rapid and sustained growth
• Rapid growth of exports
• Rapid demographic transition
• Rapid agricultural transformation
• Rapid industrialization
Equal income distribution
• Reduced poverty
• Improving social indicators

2. *Challenges and perspectives of the development of the Indo-Chinese countries*

The economic strategy and policy reforms which have already been formulated by the Governments of the Indo-Chinese countries since the mid-1980s seem to be on the right track. The outstanding results of these bold economic reforms include the growing macroeconomic stability in these countries, particularly in curbing inflation, the creation of a stable environment for business and an open-door policy in international economic relations. However, for these countries the achievement of a long and sustainable socio-economic development may depend a great deal on the solution of fundamental problems related to the very continuation of the process of the shift to a market economy. This includes defining the reasonable role of the State in managing and regulating the development, choosing an appropriate strategy for industrialization, and coordinating rapid economic growth with assurance of social equity.

The economic policy reforms which seem to be very important for the Indo-Chinese countries towards their future economic development include further reforms in the trade regime and in foreign economic policy, reforms in their fiscal and monetary policies, financial reforms, reforms of industry and agriculture, stricter regulatory institutions and a legal framework more supportive of private enterprises, strengthening the private sector and property rights, and a greater measure of political liberalization.

In terms of trade and foreign economic policy reforms, for example, the Indo-Chinese countries should ease bureaucratic restrictions on both internal and external trade which businesses must deal with. Quantitative controls on exports and imports should be further liberalized as legislated. Economic links with their East Asian neighbours and advanced capitalist countries need to be further deepened and widened. This is not only intended to acquire access to international markets, but also in order to have access to foreign investment sources.

As in the case of reforms in the foreign trade regime, much remains to be done to impose tighter monetary and fiscal discipline and to develop the financial system. The banking sector, the taxation system and budgetary policies, for example, could be better managed. In terms of the banking sector, the Government should provide adequate and effective banking services in both urban and rural areas. Also, the private credit cooperatives that the Government had encouraged as an alternative to the formal banking system should be further improved. A further improvement is necessary in the taxation system and in the management of the expenditure side of the budget. The inefficient tax system and the inability to control expenditure should be corrected.

Furthermore, as the Indo-Chinese countries are largely endowed with natural resources, particularly agricultural resources, and most of the population live in rural areas, the Governments of the Indo-Chinese countries should place a priority on the development of the agricultural and rural sectors. The Indo-Chinese countries should end the collective systems in agriculture and switch to a system of cooperation between individual autonomous peasant households. There should be attention given to land policy, the provision of public goods such as physical and social infrastructure, the encouragement of the participation of private enterprises in the agricultural sector as well as in other sectors, entry to international agricultural markets, improvements in agricultural industrialization and human resource development.

The Indo-Chinese countries should aslo widen their regional economic cooperation at least with their neighbouring ASEAN countries. Such regional cooperation is considered very important given the relatively small size of their domestic markets, the weak economic conditions prevailing in Indo-China, and the difficult nature of the transition process itself. ASEAN can be a springboard for the Indo-Chinese countries to further improve their economic development as the ASEAN countries are industrially more advanced with extensive outreach in the international market place than the Indo-Chinese countries. ASEAN can also act as a "training ground" for the Indo-Chinese countries in their export drive, by allowing them first to learn to compete in the regional market before venturing out into the international arena. Further, membership of ASEAN allows the Indo-Chinese countries to gain much visibility and recognition from the community of nations and permits them to air their views and problems more effectively and forcefully.

It is apparent that the comparative advantage of the Indo-Chinese countries lies mainly in primary products and unskilled labour-intensive light manufactured, goods whereas some ASEAN countries have gained a comparative advantage in skill-intensive and technology-intensive manufacturing. A vertical integration, with the Indo-Chinese countries specializing in upstream activities and ASEAN focusing on downstream activities, seems to be a mutually beneficial proposition. All these do not necessarily mean that the Indo-Chinese countries need ASEAN more, rather than the other way around. Ariff (1994) has suggested that, in any case, Indo-Chinese countries should not be seen by ASEAN as neighbours but as members of an extended ASEAN family.

Whatever the economic reforms undertaken by the Indo-Chinese countries in the future, one thing that is certain is that these economic reforms are part of a long-term process. The view that economic growth must be secured before social equity is open to debate. It is believed that the purpose of development in the Indo-Chinese countries is not only to achieve growth and economic effectiveness, but also to achieve results in the social field. Therefore, the Governments should work out appropriate policies to ensure a balanced and sustainable development for the whole society and different communities of population living in the Indo-Chinese countries.

G. CONCLUDING REMARKS

Viet Nam, the Lao People's Democratic Republic and Cambodia are the least developed South-East Asian countries with enormous economic potential. The pace of transformation of their economies from command systems into market economies has been quite rapid in all three economies. However, much remains to be done by these countries to achieve their development objectives.

The successes of Indonesia in its economic development since 1965 were the result of many economic policies and programmes. Public policy and institutions have played a central role in Indonesia's success. Macroeconomic management, however, appears to be one of its strongest assets, although its sequencing of reforms does not match conventional wisdom. The Indonesian Government also emphasized agricultural strategy, human resource development, infrastructure development, financial sector development, industrialization strategy and institutional set up.

With regard to agricultural strategy, for instance, Indonesia emphasized a judicious combination of incentives and central direction. Public investment in supporting infrastructure and agricultural services was crucial to Indonesia's success. Combined with this, aggressive programmes in family planning, health and education have been introduced since 1965. Similarly, the expansion of infrastructure, deregulation in the financial sector, export expansion and institutional set-up have made a significant contribution to Indonesia's success in economic development.

The lessons that the countries of Indo-China might learn from the particular development experiences of Indonesia include the significant role of the Government to prop up economic development, trade and industrial reforms, human resources development, agricultural and rural development, and sectoral reforms towards deregulation and liberalization, to name a few. Trade policies, for instance, should be liberalized to provide an optimum competitive environment; external trade and internal trade should interact competitively. In short, the lessons which can be learned by the Indo-Chinese countries from Indonesia's economic experiences are many indeed. However, the key success of these economies in achieving their economic development objectives is in the hands of the Governments of the Indo-Chinese countries, as well as the people themselves.

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II. THE DEVELOPMENT EXPERIENCE OF MALAYSIA: LESSONS FOR THE ECONOMIES IN TRANSITION IN INDO-CHINA*

A. INTRODUCTION

The Federation of Malaysia became independent in 1957 and inherited an administrative, legal and parliamentary system from the British. Since independence, the country has been governed basically by a coalition party elected in a system of parliamentary democracy.

Rapid development in the country over the last four decades has increased income levels significantly. By the end of 1994, Malaysia's per capita gross national product (GNP) was $3,500, which makes it an upper-middle-income economy, according to the World Bank. The country's policies to achieve "growth with equity" saw the rapid reduction in the incidence of poverty and a more equitable distribution of income, as well as growth in the size of the middle class. The economy was transformed from a primary commodity producer to a manufactured goods exporter and the share of manufacturing activities in the gross domestic product (GDP) has now far exceeded the agriculture sector (tables II.1 and II.2). Nevertheless, the contribution from agriculture is still significant and the country continues to be a major producer of palm oil, rubber, cocoa, pepper and tropical hardwood.

Economic progress has created employment opportunities and, by the end of 1994, Malaysia was enjoying full employment for its population of 19 million. Malaysia is a multi-ethnic and multi-religious society where 60 per cent of the population are Malays and other indigenous groups, 25 per cent Chinese, 10 per cent Indians and 5 per cent other, ethnic categories.

Malaysia's development effort was premised on a pro-business growth strategy. The approach chosen has been that of a mixed economy, with the private sector playing a dominant role and the public sector providing active support. While undertaking indicative economic planning through various development plans, Malaysia has pursued

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Table II.1. Malaysia: growth in real gross domestic product and rates of inflation and unemployment, 1971-1994

(Percentage)

	Real GDP	*Inflation*	*Unemployment*
1971	5.9	1.6	5.6
1972	9.0	3.2	6.4
1973	10.7	10.5	5.6
1974	7.2	17.4	5.7
1975	0.5	4.5	6.4
1976	12.3	2.6	6.1
1977	7.3	4.8	6.1
1978	6.0	4.9	6.1
1979	7.3	3.6	5.6
1980	7.4	6.7	5.6
1981	6.9	9.7	4.7
1982	6.0	5.7	4.6
1983	6.2	3.7	5.2
1984	7.8	3.6	5.8
1985	-1.1	0.4	6.9
1986	1.2	0.6	8.3
1987	5.4	0.8	7.3
1988	8.9	2.5	7.2
1989	9.2	2.8	6.7
1990	9.7	3.1	5.1
1991	8.7	4.4	4.3
1992	7.8	4.7	3.9
1993	8.3	3.6	3.0
1994	8.5	3.7	2.8

Source: Department of Statistics, Malaysia.

Table II.2. Malaysia: structure of production, 1960-1994
(Percentage of GDP)

Year	*Services*	*Construction*	*Manufacturing*	*Mining*	*Agriculture*
1960	45.0	3.0	5.0	7.0	34.0
1970	36.2	3.8	13.9	13.7	29.0
1980	40.1	4.6	19.6	10.1	22.9
1985	43.6	4.8	19.7	10.4	20.8
1990	42.3	3.5	27.0	9.7	18.7
1993	44.4	4.0	30.1	8.0	15.9
1994	44.9	4.1	31.4	7.5	14.8

Source: Department of Statistics, Malaysia.

market-oriented policies with regard to private sector investment and activities. The basic philosophy adopted, especially after 1970, emphasized growth accompanied by improvements in the distribution of income, that is, to achieve long-term sustainable growth with equity. Planning goals are thus not only set in macroeconomic terms but also in the form of social targets. These approaches, coupled with the pragmatism shown by the Government in adjusting to changing requirements and circumstances, have resulted in an impressive economic performance throughout Malaysia's post-independence history.

This paper attempts to evaluate Malaysia's development experience with a view to drawing lessons that are useful as a reference for emerging economies. The paper highlights the features of a rapidly growing economy within a plural society that demands equitable distribution from development. The prerequisites of policy fundamentals and institutions have made possible the path to sustained economic development.

B. A RAPIDLY GROWING ECONOMY

Malaysia's economic performance has historically been closely linked to international trade. Beginning with the colonial era, when rubber and tin featured prominently as important primary commodities for export, the openness of the economy has been an important factor in Malaysia's development. At an early stage, after independence, Malaysia realized that the economy was very vulnerable to the vagaries of international trade and, it has been said that, when industrialized economies caught a cold, Malaysia suffered high fever. Understandably then, the focus was on how to contain such externally induced instability and, at the same time, strengthen, expand and diversify the country's economic base.

Since independence and up to the mid-1980s, the Government adopted deficit financing to finance development programmes in order to provide social and physical infrastructure, particularly roads, railways, air transport, schools, universities, hospitals and clinics, and other social amenities including public utilities. Such expenditure accounted for two thirds of development expenditure. The economy was fundamentally primary commodity-based, and development policy focused on rural development, diversification of agricultural production and industrial development.

As a result of this policy, Malaysia emerged in the 1980s with a broader based development of the economy, mainly through agricultural diversification into timber, palm oil and cocoa as important export commodities, and greater reliance on oil and gas. Industrial development accelerated to further strengthen the economic base and exports of manufactured goods surged through efforts that promoted foreign investment in the country.

1. Structural adjustment

With the global recession in the early 1980s, Malaysia's external trade took a turn for the worse. The traditional strength of the country's balance-of-payments position was undermined, during the period 1981-1985, by both cyclical and structural factors that resulted in a slowdown in export growth with subsequently caused a deterioration in the terms of trade. The high import intensity and excessive demand relative to available resources resulted in a cumulative deficit on the merchandise trade account. The net result was unbalanced growth, high fiscal and external deficits and a steep rise in the external debt. This called for a thorough re-examination of the economy and the institution of structural adjustments to restore economic balance and stability.

During the four years, 1983-1987, following the recession, the Government managed to reduce the fiscal deficit and the level of national indebtedness, maintained stable exchange rates and contained inflation to 2 to 3 per cent. As a consequence of drastic measures arising from this restructuring, the economic position of the country was enhanced as follows:

- The debt service ratio declined to 6.0 in 1992 from a high of 16.4 per cent in 1987.
- The budget deficit was contained and removed completely in 1993 compared to a high of 14 per cent of GNP over the period 1980-1984.
- The overall balance of payments, as shown in table II.3, improved because of strong export growth, particularly in merchandise exports, and the increased inflow of capital which led to an impressive surplus of $11.4 billion in 1993.
- Foreign direct investments (FDI), as shown in table II.4, reached its peak in 1992 with a total of $7.1 billion and the period of 1988-1992 witnessed an overall growth rate of 9 per cent per annum. This illustrates the business confidence of foreign investors and is a reflection of Malaysia's stature as a leading location for foreign operations.
- An average rate of inflation of 3.1 per cent for the period of 1987-1993 was achieved through the implementation of appropriate monetary, fiscal and administrative policies. Aggregate demand was dampened by tightening money supply, bank credit and liquidity while fiscal measures, through spending cuts, ensured that the public sector did not become a source of upward price pressure. The administrative measures to contain excessive consumption included the imposition of strict requirements for the issuance of credit cards and hire-purchase facilities to purchase motor vehicles. Price tagging was instituted to ensure that unnecessary price increases arising from market concentration would be discouraged. The supply of food and other essential items was increased to avoid shortages.
- Malaysia's liberalization policy and the openness of its economy have encouraged best-practice operations from Malaysian companies and have enabled the production of quality and competitive products for the international markets. Excellent infrastructure facilities and a conducive regulatory environment, as well as stable prices, contributed to the containment of the cost of production, which enabled Malaysian products to continue to be competitive in international markets.

Table II.3. Malaysia: balance of payments, 1960-1994

(M$ billion)

	Merchandise	*Services*	*Current account*	*Overall balance*
1960	1,009	-379	433	430
1961	539	-364	-18	78
1962	340	-310	-164	21
1963	286	-324	-219	-77
1964	275	-360	-159	-138
1965	526	-395	60	134
1966	553	-407	40	65
1967	475	-351	-18	-41
1968	637	-400	94	177
1969	1,613	-702	731	310
1970	1,067	-862	25	68
1971	686	-878	-329	203
1972	365	-906	-698	389
1973	1,594	-1,197	246	576
1974	540	-1,743	-1,307	452
1975	614	-1,722	-1,187	171
1976	3,722	-2,148	1,474	2,054
1977	3,738	-2,586	1,074	755
1978	3,690	-3,337	249	625
1979	6,908	-4,858	2,033	1,789
1980	5,238	-5,813	-620	1,002
1981	-243	-5,312	-5,633	-1,093
1982	-1,758	-6,576	-8,409	-614
1983	1,002	-9,098	-8,117	-55
1984	6,986	-10,813	-3,917	312
1985	8,883	-10,391	-1,522	3,209
1986	8,378	-8,790	-316	4,345
1987	14,703	-8,409	6,642	2,893
1988	14,703	-10,180	4,739	-1,104
1989	11,871	-11,392	698	3,332
1990	7,093	-9,723	-2,483	5,365
1991	1,449	-13,195	-11,644	3,427
1992	8,599	-13,611	-4,675	16,744
1993	8,193	-14,951	-6,349	29,239
1994	5,877	-17,741	-11,657	5,266

Source: Department of Statistics, Malaysia.

Table II.4. Malaysia: approved manufacturing sector projects, 1971-1994

Year	*Total investment*	*Domestic investment*	*Foreign investment*	*Number of projects*
1971	631.0	484.0	147.0	264
1972	557.0	310.0	248.0	332
1973	1,193.0	625.0	568.0	460
1974	1,425.0	870.0	555.0	509
1975	1,428.0	1,032.0	395.0	453
1976	1,054.0	761.0	293.0	409
1977	854.0	601.0	253.0	397
1978	1,063.0	687.0	376.0	423
1979	4,105.0	2,654.0	1,451.0	476
1980	2,103.0	1,374.0	731.0	459
1981	4,448.4	3,139.1	1,309.3	596
1982	5,434.8	3,808.2	1,626.6	468
1983	2,358.1	1,729.0	629.1	490
1984	3,801.1	3,083.1	718.0	749
1985	5,686.9	4,727.6	959.3	625
1986	5,163.2	3,475.3	1,687.9	447
1987	3,933.9	1,873.9	2,060.0	333
1988	9,093.9	4,215.9	4,878.0	732
1989	12,215.4	3,562.7	8,652.7	792
1990	28,168.1	10,539.0	17,629.1	906
1991	30,818.4	13,763.1	17,055.3	973
1992	27,775.1	10,003.0	17,772.1	874
1993	13,753.0	7,466.5	6,287.0	686
1994	22,668.9	11,444.8	11,224.0	871

Source: Department of Statistics, Malaysia.

Note: Average exchange rate is $1.00 = M$2.55.

- There was improved distribution of income through the Government's policy of growth with equity. The incidence of poverty was reduced from 49.3 per cent in 1970 to 13.5 per cent in 1993. Domestic ownership of equity in the private corporate sector increased to 67.6 per cent by 1993, of which 18.2 per cent represented the share of the indigenous group which had risen from a low of 2.4 per cent in 1970 (table II.5). Equity ownership by foreigners fell from 63.3 per cent in 1970 to 32.4 per cent in 1993. In absolute terms, however, foreign equity increased through the expansion of the total corporate equity structure.
- The country's deregulation and privatization measures and the "Malaysia Incorporated" policy have introduced a new approach in public sector management that is more proactive, focused and aggressive in order to achieve developed nation status as embodied in "Vision 2020".

Table II.5. Malaysia: equity ownership and poverty rate, 1970, 1990 and 1993
(Percentage)

Equity ownership	*1970*	*1990*	*1993*
Bumiputera and indigenous	2.4	20.3	18.2
Other Malaysians	32.3	46.2	40.0
Chinese		44.9	37.8
Indians		1.0	1.1
Others		0.3	1.1
Foreigners	63.3	25.1	32.4
Nominees	2.0	8.4	9.4
Poverty rate	49.3	17.1	13.5

Source: Department of Statistics, Malaysia.

C. THE RIGHT POLICY FUNDAMENTALS

Malaysia's success in achieving high sustained growth can be summed up as "getting the basics right". This means instituting sound development policies, good economic management, strong private domestic investment initiatives and high quality human resources. However, development thrives best in an environment of social and political stability. Such an environment can only be accomplished if the people benefit from development through better access to housing, enjoy basic services and amenities, and command high incomes. While the development efforts of the Government and the activities of the private sector depend on the market mechanism to spur growth, the Government is concerned with equity so that the fruits of growth can be enjoyed by a large majority of the population. At the same time, the Government has to ensure a stable macroeconomic environment.

1. A plural society in peaceful coexistence and harmony

The multiracial nature of Malaysian society has exerted pressures and demands that have strained the democratic institutions of the country. The incidence of poverty, coupled with economic and regional imbalances, was a potentially destabilizing factor that had to be urgently addressed by the Government. The launching of the New Economic Policy (NEP) in 1970 was the most significant policy change which incorporated social and economic objectives to eradicate poverty, irrespective of race, and to restructure society to reflect the ethnic composition of the nation in order to ensure a united, socially just, economically equitable and progressive society. The basic philosophy was growth with equity and national unity was the overriding objective. This policy was to be implemented within the context of rapid economic expansion.

Malaysia's plural society (table II.6) has found a formula for peaceful coexistence and harmony despite ethnic and religious diversity. This formula was not discovered fortuitously. Rather, it was the result of conscientious and considerable thoughts and efforts. Its main ingredients are as follows:

- Those involved in the drafting of the Federal Constitution were mindful of the potentially explosive nature of ethnic relations and wisely entrenched in the Contribution provisions which authorize Parliament to legislate against, *inter alia*, people who promote feelings of ill-will and hostility between different races or other classes of the population, that are likely to cause violence;
- The relevant government agencies have managed to prevent ethnic tension from transforming itself into ethnic violence, almost without fail;

Table II.6. Malaysia: population distribution by ethnic group, 1994

(Percentage)

	Population distribution
Ethnic group	
Malay and indigenous	68.2
Chinese	28.8
Indian	7.9
Others	0.5
Total population (million)	19.5

Source: Department of Statistics, Malaysia.

- The curriculum of the public education system has been developed not only to prepare the young for the demands of the job market but also to instil in them a set of common values and a sense of being Malaysian;
- Most importantly, ethnic groups in Malaysia have demonstrated a strong preference for negotiation and accommodation rather than open confrontation to resolve ethnic differences. A clear indication of this is the repeated victory, in every general election since 1955, of the Alliance Party and its successor, the National Front, both coalitions of ethnic parties, that have consistently emphasized consultation and compromise on ethnic issues. The continuing support for the coalition party has not only reduced publicized and politicized debates on ethnic issues, thus avoiding potential conflict, but has also produced political stability and allowed ethnic leaders who believe in consultation and compromise to work together as national leaders/Cabinet colleagues for the overall development of Malaysia.

The net result of these efforts has been to cut down ethnic tension and violence. In its place, peaceful coexistence among the ethnic groups has enabled Malaysians to direct and concentrate their resources on economic and social development.

2. *A government in tune with the electorate and fully committed to socio-economic development*

Reflecting the preference of Malaysians in general, the Government has subscribed strongly to the belief that economic development, if it is to be really meaningful and sustained, must involve and accrue to all citizens, including the poor, unemployed, marginalized communities and generally disadvantaged groups. This philosophy of growth with equity is embodied in all major public policies of Malaysia. Among them policies, three can be regarded as being the most important: the New Economic Policy (NEP), the National Development Policy (NDP) and Vision 2020.

NEP (1971-1990) was the product of pragmatic thinking on the desirable direction of national development, that is, growth with equity and active government participation in the economy and not maximum growth through a laissez faire or free market economic system. It was born out of a realization that the shortcomings of the laissez faire system, which had been in place since independence, were a major contributing factor to the tragic, but fortunately short-lived, ethnic riots in 1969. This system was inadequate and incongruous for a plural society in which different ethnic groups were at different levels of economic development. A policy of total laissez faire would only exacerbate entrenched group differences, creating resentment among those left behind by the forces of growth and eventually leading to a breakdown in social cohesion. Thus, the Government intervened to ensure equitable growth and introduced the NEP, now famed, but in its early years, viewed by some pro-market economists with apprehension.

The NEP had, as its goal, something beyond mere economic or materialistic development which, in a nation of many ethnic and religious groups, was of paramount importance. This special goal was national unity and all Malaysians have willingly accepted that loyalty and dedication to the nation override all other loyalties. To achieve this goal, two major strategies were adopted. The two strategies were:

- Reducing absolute poverty, with the intention of eventually eradicating it, by raising income levels and increasing employment opportunities for all Malaysians, irrespective of race;
- Restructuring society to correct economic imbalances so as to reduce and eventually eliminate the identification of race with economic function.

Another feature of NEP was that it was predicated upon a rapidly growing economy. This was deemed necessary because it would provide increased employment or economic opportunities for the poor and other disadvantaged groups to enable them to get out of poverty and to participate in the mainstream of economic activities; and it would ensure that distribution did not take place from the reallocation of existing wealth but from expanding and new sources of wealth.

NDP (1991-2000), introduced in 1991 as the successor to the NEP as Malaysia's all-encompassing development policy, reaffirmed the relevance of the latter by retaining its main elements. But, at the same time, in view of the emergence of fresh challenges, NDP introduced several new thrusts for balanced development. These new thrusts, together with the old, served to emphasize the growing concern of Malaysians that increasing consideration be given to non-materialistic matters in national development such as the strengthening of social and spiritual values and protection of the environment and ecology. Specifically, new thrusts for balance development involved:

- Striking an optimum balance between the goals of economic growth and equity;
- Ensuring a balanced development of the major sectors of the economy in order to increase their mutual complementarities and optimize growth;
- Reducing and ultimately eliminating the social and economic inequalities and imbalances in the country so as to promote a fair and more equitable sharing of the benefits of economic growth by all Malaysians;
- Promoting and strengthening national integration by reducing the wide disparities in economic development between states and between urban and rural areas in the country;
- Developing a progressive society in which all citizens enjoy greater material welfare, while simultaneously imbued with positive social and spiritual values, and an increased sense of national pride and consciousness;
- Promoting human resource development, including creating a productive and disciplined labour force, and developing the necessary skills to meet the challenges in industrial development through a culture of merit and excellence without jeopardizing restructuring objectives;

- Making science and technology an integral component of socio-economic planning and development, which entails building competence in strategic and knowledge-based technologies, and promoting a science and technology culture in the process of building a modern industrial economy;
- Ensuring that, in the pursuit of economic development, adequate attention will be given to the protection of the environment and ecology so as to maintain the long-term sustainability of the country's development.

With regard to balancing growth and equity, which was the primary focus of NEP, NDP introduced the following shifts in strategies to eradicate poverty and restructure society:

- Shifting the focus of the anti-poverty strategy towards eradication of hardcore poverty while at the same time reducing relative poverty;
- Focusing on employment and the rapid development of an active Bumiputera commercial and industrial community as a more effective strategy to increase the meaningful participation of the indigenous people in the modern sectors of the economy;
- Relying more on private sector involvement in the restructuring objective by creating greater opportunities for its growth;
- Focusing on human resource development as a fundamental requirement to achieve the objectives of growth and distribution.

Vision 2020, which is a vision of what Malaysia should be like in the year 2020, has become the basis for planning Malaysia's future. In essence, it calls for total development and envisages that, "by the year 2020, Malaysia can be a united nation, with a confident Malaysian society, infused by strong moral and ethical values, living in a society that is democratic, liberal and tolerant, caring, economically just and equitable, progressive and prosperous and in full possession of an economy that is competitive, dynamic, robust and resilient."

To realize the Vision, nine strategic challenges will have to be met. These are:

- Establishing a united Malaysian nation with a sense of common and shared destiny. This must be a nation at peace with itself, territorially and ethnically integrated, living in harmony and full and fair partnership, made up of one "Bangsa Malaysia" (Malaysian society) with political loyalty and dedication to the nation;
- Creating a psychologically liberated, secure and developed Malaysian society with faith and confidence in itself, justifiably proud of what it is, of what it has accomplished, robust enough to face all manner of adversity. This Malaysian society must be distinguished by the pursuit of excellence, fully aware of all its potential, psychologically subservient to none, and respected by the peoples of other nations;
- Fostering and developing a mature democratic society, practising a form of mature consensual, community-oriented Malaysian democracy that can be a model for many developing countries;
- Establishing a fully moral and ethical society, whose citizens are strong in religious and spiritual values and imbued with the highest of ethical standards;
- Establishing a mature, liberal and tolerant society in which Malaysians of all colours and creeds are free to practise and profess their customs, cultures and religious beliefs and yet feeling that they belong to one nation;
- Establishing a scientific and progressive society, a society that is innovative and forward-looking, one that is not only a consumer of technology but also a contributor to the scientific and technological civilization of the future;
- Establishing a fully caring society and a caring culture, a social system in which society will come before self, in which the welfare of the people will revolve not around the State or the individual but around a strong and resilient family system;
- Ensuring an economically just society. This is a society in which there is a fair and equitable distribution of the wealth of the nation, in which there is full partnership in economic progress. Such a society cannot be in place so long as there is

the identification of race with economic function, and the identification of economic backwardness with race;

- Establishing a prosperous society, with an economy that is fully competitive, dynamic, robust and resilient.

In effect, Vision 2020 is very much like NDP and NEP in giving an emphatic focus to the achievement of a suitable balance among competing concerns in development. It manages, however, to add a further humanistic element to the Malaysian concept of development. This element, highlighted in the seventh challenge, stresses the importance of creating a fully caring society and a caring culture based upon a strong and resilient family system which is expected to harbour individuals from the negative effects of development in a more effective way than the government-based social security systems currently employed by many countries.

The idea that development should not be directed solely at maximizing economic growth has been an important feature of major Malaysian national development policies. In addition, since the introduction of this idea in NEP, it has been broadened to include not only the need to balance growth with distribution but a host of other factors as well. The continuous emphasis given to the above ideal reflects the Government's awareness that it is something to which most Malaysians subscribe and also underlines the Government's own commitment to the ideal.

3. Political and social stability

Political and social stability are important ingredient of development. Furthermore, with Malaysia's dependence on foreign investments, political and social stability have been ranked as the most important factor to encourage foreign investors to invest in Malaysia.

All Malaysians, particularly the disadvantaged groups, have benefited from development. Malaysia's development, with its accent on growth and equity, has reduced the incidence of poverty to 13.5 per cent in 1993 and narrowed the income gap. The income of the top 20 per cent of households increased by 10.9 per cent per annum while that of the bottom 40 per cent increased by 8.4 per cent. This improvement is reflected in the decrease of the gini coefficient from 0.51 in 1970 to 0.45 in 1993. While the various poverty redressal programmes contributed towards poverty alleviation, a new focus was introduced which targeted the hardcore poor.

This shift in focus enabled special programmes to be formulated to meet the specific needs of this disadvantaged group. These efforts were made possible through the continued expansion of the economy.

Malaysia's social integration policies seek to achieve two major objectives. First, by addressing the problems and needs of individuals and groups that have been negatively affected by, or have not benefited from, the processes of economic growth and modernization, the policies seek to incorporate them into the mainstream of economic and social life. Prominent examples of these policies are the national social welfare policy and the national policy on women. Second, the social integration policies seek to create a feeling of oneness among the many ethnic groups of Malaysia. The major policies with this objective include the aforementioned NEP and NDP, but language, education and cultural policies are also important.

The national social welfare policy (NSWP), first introduced in 1990, is Malaysia's all-encompassing policy which takes cognizance of the problems and pressures created by growth and modernization on individuals and particular social groups, and the threat to social harmony and integration that it promises to generate. It aims to create a society whose members are imbued with the spirit of self-reliance, enjoy equal opportunities and care for one another, particularly for the less fortunate.

To achieve this objective, NSWP proceeds from the premise that in dealing with social problems, curative and rehabilitative approaches alone will not be sufficient. They have to be complemented by preventive and developmental strategies as well. In view of this, there is a discernible emphasis on the latter in the major strategies of NSWP, as follows:

- Developing human potential to its optimum, and strengthening social resilience to cope with the challenges of a rapidly growing economy and its spillover effects;
- Providing the necessary facilities and amenities for increasing the capabilities of individuals and groups to develop themselves;
- Building and nurturing a culture of caring and cooperation.

In implementing the strategies, NSWP requires that more than just government agencies be involved, as was usually the case in the past. Instead, it stresses that individuals, families, groups, non-governmental organizations, local communities and the private sector should be equally and actively involved. In effect, the emphasis is on the whole society working together to help its less fortunate members to face life's challenges, thereby strengthening them and, in the process, strengthening the society itself.

These conscious policies aimed at poverty alleviation, social integration and national social welfare set the stage for political and social stability because the citizens can effectively participate in the economic, social and political development of the country. The need to ensure that political processes contribute to increased social welfare and economic opportunities for individuals and corporate entities is essential for sustained entrepreneurial activity that is a prerequisite for economic progress in a market-based system.

Government development programmes are geared to benefit the populace through transparent policies and, more importantly, through direct participation in the numerous development programmes such as land resettlement, infrastructure construction, social programmes, agricultural support programmes and educational advancement programmes where the second generation are better positioned to participate in modern activities which provide a better standard of living. Perhaps Malaysia has successfully demonstrated that long-term perspectives are faithfully pursued for the people's benefit and this has fostered a consensus towards accepting a national agenda for development. This has brought about a national focus to develop the country in an environment of social and political stability, where the invisible hand operates most efficiently once the necessary institutions of the rule of law, financial markets and private enterprise are firmly established.

4. Macro-economic stability

Apart from preserving social and political stability, the pursuit of economic growth should be premised on the maintenance of macroeconomic stability. The periods of high growth, particularly from 1988 to 1994, of more than 8 per cent per annum, with low inflation of less than 4 per cent per annum, has demonstrated that macroeconomic policies to maintain price stability have been successful. Malaysia's experience with inflation has shown that any substantive change in foreign prices will eventually be reflected in domestic prices, as happened during the oil shocks of 1973-1974 and 1981-1981 (table II.1). In fact, it was during these oil-shock periods that Malaysia experienced two distinct periods of price increases. Following a surge in oil prices of 40.5 per cent in 1993, the rate of increase in the consumer price index peaked at 17.4 per cent in 1974. Again, in 1980 to 1981, when oil prices increased by 48.9 per cent, consumer prices rose by 9.7 per cent in 1981. Apart from these exceptional periods, however, Malaysia's inflation rate has been relatively low.

In general, Malaysia has experienced stable prices, a high level of savings and, in relation to the external economy, stable exchange rates and a generally favourable current account position. The curb on rising prices has been made easier with reasonably high savings levels. National savings as a percentage of GNP have not dipped below 25 per cent since 1972 (table II.7). In 1994, savings as a proportion of GNP were about 34 per cent. This high savings rate has helped to dampen consumption growth and to mobilize domestic funds for the high rate of investment growth.

Fiscal policy in Malaysia since independence has always been conducted with prudence. The five-year plans are taken very seriously and the public sector investment expenditure plan is developed taking into account the overall macroeconomic framework, that is, the state of public finance, the balance-of-payments position and, more importantly, the capacity of the administration to carry out the expenditure programme successfully. Budget deficits were kept within prudent limits as a percentage of GNP and the policy that operating expenditure must be wholly financed from government revenue was maintained (table II.8).

Table II.7. Malaysia: savings-investment balance

Year	*Savings*	*Investment*	*Resources balance*
1977-1981	29.4	29.4	0
1982-1986	27.3	34.2	-6.9
1990	30.6	32.8	-2.2
1991	28.4	37.9	-9.5
1992	32.1	35.4	-3.3
1993	32.7	36.9	-4.2
1994	33.9	39.1	-5.2
1995	33.3	39.7	-6.4

Source: Department of Statistics, Malaysia.

Table II.8. Malaysia: public sector performance, 1970-1994
(M$ billion)

Year	*Revenue*	*Operating expenditure*	*Development expenditure*	*Overall balance*
1970	2,400	2,163	725	-475
1971	2,418	2,398	1,085	-1,050
1972	2,920	3,068	1,242	-1,371
1973	3,399	3,342	1,128	-1,049
1974	4,791	4,318	1,878	-1,381
1975	5,117	4,900	2,151	-1,901
1976	6,157	5,528	2,378	-1,705
1977	7,760	7,098	3,217	-2,476
1978	8,841	7,391	3,782	-2,249
1979	10,505	7,890	4,281	-1,535
1980	13,926	10,292	7,470	-3,704
1981	15,806	13,686	11,358	-9,015
1982	16,690	15,922	11,485	-10,421
1983	18,608	16,124	9,670	-6,933
7984	20,805	17,506	8,407	-4,775
1985	21,115	18,766	7,142	-4,407
1986	19,518	20,075	7,559	-7,506
1987	18,143	20,185	4,741	-6,153
1988	21,967	21,212	5,231	-3,290
1989	25,273	22,982	7,696	-3,410
1990	29,521	25,026	10,689	-3,437
1991	34,053	28,296	9,565	-2,640
1992	39,250	32,075	9,688	-1,243
1993	41,691	32,217	10,124	354
1994	49,446	35,064	11,276	4,409

Source: Department of Statistics, Malaysia.

The use of borrowed funds was only for investment expenditure which would create new economic activities that contribute to greater capacity and output. This prudent financial discipline has avoided excessive debt burdens and, with healthy export growth, the debt-service ratio has been kept within prudent limits.

Malaysia's exchange rate against major currencies has remained relatively stable. For instance between 1970 and 1994, the value of the ringgit (M$) against the United States dollar remained between M$2.19 and M$3.04 to the dollar and is currently about M$2.46 to the dollar. This has certainly facilitated international trade and has attracted foreign investments which have been important to the growth of a small open economy like Malaysia. The FDI inflows have not only provided the needed funds for investment but, more importantly, provided the framework for the transmission of expertise and technology which is critical in advancing Malaysia towards becoming an industrialized nation.

The current account position, however, has not been as enviable and has been characterized by prolonged periods of deficit as is happening currently. The current account position has been vulnerable, especially because of the economy's heavy dependency on imported services and, lately, to high repatriation of profits, dividends and interest. However, this situation is not as critical as it seems because the surplus in the capital account has been able to offset the current account deficit. More significantly, the deficit has been largely due to the purchase of capital and intermediate products. It is expected that, when these investments come into production, exports will increase and the current account will improve.

However, international capital flows, which represent an important source of internal financing for domestic economic activity, will become a matter of concern when it is destabilizing to the economic and financial system. Inflows for direct long-term investment are encouraged but inflows that are temporary and speculative in nature will contribute to the destabilization of the domestic financial markets. Therefore, while emerging countries have liberalized, deregulated and introduced tax incentives to induce foreign capital inflows, the positive effects of these flows on the economy should be balanced against the potential adverse effects that they might have on macroeconomic stability. Malaysia's recent experience with massive destabilizing inflows and the adoption of successful monetary policy measures to remedy the situation rapidly provide important lessons. Perhaps the lesson that can be drawn is that policies based on domestic considerations alone cannot be sustained for any long period of time. Eventually, the market would adjust with the usual consequence of increased volatility. However, administrative measures are necessary, as a temporary measure to combat the speculative element in extreme circumstances. These measures should be removed immediately once the situation improves because they are distortionary and might introduce further uncertainties into the market.

The growth of the capital market is important for mobilizing resources to meet the ever-increasing funding requirements and to ensure that both costs and returns are reasonably satisfactory. The simultaneous development of equity and private debt securities provides the private sector with the necessary resources to undertake the development of large infrastructure projects.

Measures have been undertaken by the Government to mobilize domestic savings. Apart from compulsory savings through the Employees Provident Fund, Social Security and the Human Resources Development Fund, various new savings schemes in the form of bonds and unit trusts, were introduced, in addition to the existing voluntary saving schemes of the Pilgrimage Fund and the National and Bumiputera Unit Trusts. In addition, the development of the Islamic financial system, functioning parallel to the conventional system, further provided variety to the savings scheme.

The open and increasingly liberal policy of the Government has provided the drive to strengthen private sector participation and the expansion of the economy. This open environment will encourage a freer flow of funds and enable the mobilizing of foreign and domestic resources to develop further the various social and physical amenities which would facilitat trade and investment. Malaysia has been fortunate to have been able to attract large inflows of FDI and to borrow easily from international sources to finance its development. However, this situation is changing with the rapid development taking place in China, Viet Nam and other emerging economies.

5. Efforts at structural transformation

Malaysia does not practise a pure laissez-faire system. Experience has shown that a certain amount of intervention and direct participation in the form of industrial policy is found to be essential as well as beneficial.

During the NEP period, increased participation of the public sector in the economy was the most effective means of ensuring the objective of reducing poverty and restructuring of society as well as job creation through rapid agricultural and industrial development. The Government also found it essential to participate effectively in the economic opportunities that were generated in the economy, particularly in the industrial sector.

The Government's direct involvement at the initial stage of heavy industrialization under the auspices of the Heavy Industries Corporation of Malaysia, which initiation iron, steel plants and the first national car project in the early 1980s, also produced indelible results. The Government's role was essential to meet the substantial capital requirements and to build private sector confidence in totally untested areas. But it is most important to note that the Government's involvement in these pursuits was only transitory and to ensure "take-off". This strategy would allow the growth of a private sector of viable size to take over as the engine of growth. The Government later gradually withdrew from these activities. The Government has, in fact, since the mid-1980s consolidated its position and the economy today is driven by the private sector.

Malaysia's industrialization programme began in an initial environment where foreign investment was predominant in the manufacturing sector. Therefore, the initial focus was on changes in ownership and employment patterns in order to strengthen the domestic industrial capability. The easiest route was towards import substitution to develop critical basic industries such as building materials (iron, steel and cement), basic metal and engineering, petrochemicals and automobiles. FDI inflows will not venture into these domestic-oriented industries. Unlike other countries, this focus on internal industrial objectives was instituted in parallel with the development of vibrant export-led industries by multinational companies which operate globally. Generally, internal technological capabilities must be present to expedite the process of technology transfer to domestic enterprises in joint ventures with multinational companies.

With the participation of the multinational companies, the share of manufactured exports rose rapidly. The transformation involved a shift away from dependence on exports of primary products towards manufactured goods. The successful developing of manufactured exports was critical to this process because Malaysia has already accomplished the easy first stage of import substitution and was involved in the second stage of import substitution. However, this second stage involves the replacement of imports of capital and intermediate goods and of producer and consumer durable goods by domestic production. These types of goods, such as steel, automobiles and petrochemicals, tend to be capital-intensive and are subjected to important economies of scale. The size of the domestic market limited the possibilities of domestic competition in industries established at the second stage of import substitution, during which import competition was excluded by moderate levels of tariff protection. These conditions further emphasized the importance of exporting manufactured goods and changing the composition of these exports.

The distinctive shift from labour-intensive to skill-intensive manufactured exports necessary to accommodate the loss of comparative advantage arising from a relatively high level of wages and a presumably low level of productivity. Manufactured exports were now confined not only to textiles, computer chips and simple electrical appliances but to more skill-based inputs where the higher wages are reflected in the value-added production processes.

The Malaysian experience suggests that successful industrialization must attempt to build internal industrial capacity through local ownership and skills in an environment of stiff competition provided by the presence of multinational companies that serve the global marketplace. The presence of best practice operations will ensure that reasonable, rather than excessive protection, is provided for infant industries. This policy has made it easier for Malaysia gradually to reduce tariffs in the wake of greater liberalization arising from efficiency gains. Government intervention in import-substituting industries did not produce an anti-export bias; instead both were promoted simultaneously. The Malaysian Government's intervention in industrial policy is based on the premise that it facilitates the private sector which will ultimately undertake the activity. It is a method of temporary intervention either to level the playing field or to correct some market failures.

6. Export-led growth orientation

Malaysia's international trade policy is a reflection of the continuation of past policies and the emerging realities of globalization and trade liberalization. Malaysia has long realized its vulnerability arising from the volatile and reliance on contracting earnings from exports of primary commodities, such as tin and rubber, and that a shift to high value-added processed manufactured goods would provide better returns. Malaysia's economy has become more diversified with the promotion of export-led industries (table II.9). The share of rubber in merchandise exports declined significantly from 33.4 per cent in 1970 to about 1.8 per cent in 1984. The most remarkable achievement was with respect to manufactured exports, which rose from 12 per cent in 1970 to 78 per cent in 1994 as a result of greater industrialization efforts.

Table II.9. Malaysia: diversification of exports
(Percentage of total exports)

	1970		*1980*		*1990*		*1994*
Rubber	33.4	Rubber	16.4	Tin	1.1	Forestry	4.5
Tin	19.6	Tin	8.9	Forestry	8.9	Rubber	1.9
Forestry	16.3	Forestry	13.5	Rubber	3.8	Manufacturing	78.2
Oil and gas	3.9	Oil and gas	23.8	Oil and gas	13.4	Oil and gas	6.1
Manufacturing	11.9	Others	6.1	Others	5.1	Tin	0.3
Palm oil	5.1	Manufacturing	22.4	Manufacturing	58.8	Palm oil	5.5
Others	9.8	Palm oil	8.9	Palm oil	5.5	Others	3.2
Total (million M$)	5.163		28.172		79.646		153.700

Source: Department of Statistics, Malaysia.

Basically, the essential elements for a successful export drive are:

- Full commitment by the Government to an export-oriented growth strategy based on manufactured exports;
- A holistic implementation of the strategy involving consistent exchange rate, import and export policies;
- The implementation of these policies over a sustained period of time.

For example, the development of technically skilled manpower to support the export drive is a deliberate national effort that includes but goes beyond active responses to market signals and forces. To become a major world exporter of manufactured goods visible in world trade as a significant supplier requires an act of national will and the marshalling of energies behind it. In short, the efforts should have a national focus in order to ensure the convergence of a variety of forces, efforts and circumstances. The normal trend of growth for Malaysia would not have yielded the quantum jumps in manufactured exports and the structural adjustment within the manufacturing sector.

Malaysia's economy has always been relatively open. An open economy calls for greater increases in productivity to be able to face stiff competition in the international market. The exports of a nation can only gain access or strengthen its foothold in foreign markets if competitiveness, measured in terms of productivity, product design and quality are at a high level. Malaysia, with average import duties of about 15 per cent, is one of the least protected among developing countries and its import-licensing requirements are at a minimum level. In the recent 1995 budget, Malaysia unilaterally reduced or abolished import duties and tariff on more than 2,600 items, including more than 700 consumer goods. This gradual liberalization is possible because of the successful build-up in capacity and the efficiency gains of infant industries arising primarily from joint ventures with foreign investment.

7. *Physical and social infrastructure*

Malaysia has consistently and continuously allocated sizeable portions of funds to expand and upgrade its infrastructure facilities to meet the demands of a rapidly growing economy. The Government has boldly engaged the private sector in infrastructure development, an activity traditionally carried out by the public sector.

It is undeniable that the availability of infrastructure has been an important factor contributing to the rapid growth of Malaysia's economy. A good and modern infrastructure system will act as a catalyst for economic growth by providing the necessary thrust for the undertaking of economic activities. On the other hand, inadequate facilities may constrain productivity growth and act as impediments.

Physical infrastructure programmes were started with the rural development programme. For more than three decades, roads and railways were built to connect rural areas to more developed areas. Thus, by the end of its first two decades, Malaysia achieved high accessibility in transport. This has enabled development programmes to be better distributed within various regions in the country.

Infrastructure development was basically the responsibility of the public sector during the pre-1980 period. The physical and social infrastructure has been viewed as the prerequisite for sustained and undisrupted economic development as well as to support private sector investment in the economy. This is witnessed in the budget allocation of infrastructure projects in the five-year development plans (table II.10). Even during the years of structural adjustments in the mid-1980s, infrastructure development projects were never suspended.

Table II.10. Malaysia: public sector development expenditure on physical and social infrastructure projects, 1956-1995
(M$ billion)

Development plan	*Total Value*	*Infrastructure projects*		*Social projects*	
		Value	*Per cent of total*	*Value*	*Per cent of total*
First Malaya, 1956-1960	1.007	0.520	51	0.139	14
Second Malaya, 1961-1965	3.109	1.467	47	0.528	17
First Malaysia, 1966-1970	4.550	1.538	34	0.752	17
Second Malaysia, 1971-1975	11.457	3.121	27	1.431	12
Third Malaysia, 1976-1980	37.651	10.724	29	5.561	15
Fourth Malaysia, 1981-1985	80.331	14.916	19	10.846	14
Fifth Malaysia, 1986-1990	64.590	12.115	19	8.461	13
Sixth Malaysia, 1991-1995	117.500	21.885	19	14.180	12

Source: Malaysia Development Plans, 1956-1995.

A constant share of GDP has been allocated to education and health, which were given priority. Expenditure on infrastructure, at over 12 per cent of GDP, was also substantial and strengthened the enabling environment for economic growth and employment generation.

During the First Malaya Plan (1956 to 1960), a total of M$520,000 million was spent on the transport, communication and utilities sectors. This accounted for more than half of the total development budget allocated for the entire plan period. Subsequently, during the Second Malaya Plan (1961-1965), this amount tripled to M$1.5 billion despite the slight decrease in its share of the total development budget to 47 per cent. It then took a healthy sixfold jump to M$10.7 billion in the development budget during the Third Malaysia Plan (1976 to 1980) period. For the period 1956 to 1980, infrastructure expenditure constituted an average of 38 per cent of total public sector expenditure, ranging from 27 per cent to as high as 51 per cent.

However, after the 1980s, the Government adopted new methods for the implementation of infrastructure projects because of limited public sector resources and the need to expand infrastructure capacities at an accelerated pace. The private sector was encouraged to play an active role in the development of infrastructure projects with some financial support, such as soft-loans from the government. For instance, total costs of projects privatized from 1983 to 1993 amounted to M$40 billion, while government support in the form of soft loans and land acquisition costs amounted to only M$2 billion. There was therefore a large saving of M$38 billion in development expenditure. This method of implementation of projects releases public sector finances and makes it possible for more projects to be implemented in a shorter period of time.

Government investment in social infrastructure has always been substantial since the public sector is essentially given the responsibility of meeting several social and economic objectives. During the NEP period, the Government played a more important role in providing education and basic health care as these are considered important instruments for poverty eradication. Federal government expenditure on education, health and agricultural and rural development accounted for a third of the Federal Government's total expenditure in the early years of NEP.

Development programmes also contributed towards further improvement in the overall well-being of the population. Improved social amenities, particularly in health, housing, water, electricity and telecommunications, have benefited the people. This improved well-being is reflected in increased life expectancy for both males and females (table II.11).

Table II.11. Malaysia: quality of life

	1970	*1990*	*1993*
Life expectancy (in years):			
Male	61.6	69.0	69.0
Female	65.6	73.3	73.7
Infant mortality rate/1,000	39.4	13.5	12.3
Doctor/population ratio	1:4,302	1:2,656	1:1,900
Literacy rate (per cent)	58	79	85
Telephones/1,000 people	17	114	132
Housing (persons/living quarters)	5.4	4.4	4.2
Percentage of population			
Water	47.5	78.3	83.0
Electricity	43.7	87.5	89.6

Source: Department of Statistics, Malaysia.

During the last 23 years, average life expectancy at birth has increased by 7.4 years for the male population and 8.1 years for females, to 69 and 73.7 years respectively. Thus, the life expectancy of Malaysians is already close to the current average of around 74 years for developed countries and is much higher than the current average of 62 years for developing countries.

Much of the improvement in life expectancy has resulted from dramatic drops in maternity and infant death rates. Infant mortality dropped from around 40 per thousand life births in 1970 to only 12.3 in 1993, while maternal mortality dropped from 15 to 2 per 10,000. These ratios are already approaching the average for developed countries. The substantial improvement was achieved through greater access to safe water and basic immunization.

Malaysia continues to make great strides in the provision of basic educational services to its people. Participation rates at all levels of education have been growing steadily. Primary school enrolment is virtually universal and secondary school enrolments have increased. The share of government expenditure devoted to education during the sixth plan period is 15 per cent and this proportion has not changed much over the past decade.

Malaysia's experience suggests that continuous investment in physical and social infrastructure directly improves the quality of life of all Malaysians. This improves the national support for development programmes, as well as improved facilities enjoyed by the business sector.

8. *Privatization policy*

The Government's privatization policy is an acknowledgement that the private sector is the engine of growth. This policy allowed the Government to use the public, private and foreign sectors as partners in development. Efforts from all three partners were harnessed to meet the growing demand for infrastructure facilities. Only with long-term investments can the Government ensure that Malaysia enjoys sustainable growth and the achievement of its national objectives.

To accelerate the pace of privatization in an orderly manner, the Government produced a master plan which indicated implementation procedures, assignment of priorities, a set of achievable programme targets and measures to ensure sustainability. It identified a total of 246 entities and activities that could be privatized. Currently, a total of 131 projects have been privatized; 86 of such projects involved the taking over of the Government's functions by the private sector, while the rest involved construction of infrastructure and utilities such as roads and water supply. The privatization programme is broad-based and covers a large number of economic activities.

Despite initial teething problems, the programme has achieved credible results and one of the immediate results was the reduction in the Government's financial burden. The Government's administrative burden has also been lightened through the transfer of some 92,700 employees to the private sector. Performance indicators clearly show that privatized entities have achieved a high degree of efficiency, producing more output with fewer resources. Such efficiency gains, in turn, allowed the introduction of new services and encouraged the private sector to invest confidently in sectors previously in the domain of the public sector.

However, such success did not come easily. There were a number of issues and obstacles that had to be resolved. These issues included resistance from government departments and agencies, legal constraints, regulations on monopolies, foreign participation, the absorptive capacity of the domestic capital market and, importantly, the perceived fears of the employees. To counter such resistance and allay unfounded fears, the Government introduced several policy guidelines. To protect the interests of workers, no personnel could be retrenched in the first five years of privatization and employees of would-be privatized entities had to be offered no less favourable terms of service than they had enjoyed during their term of service with the Government. Consumer anxieties were dispelled through the implementation of a regulatory framework. This regulatory framework is responsible for protecting consumer interests and public safety from monopoly power, promoting social objectives and creating healthy competition in related industries. The legal constraints were overcome through a pragmatic approach by amending the relevant laws and regulations.

Due attention was given to the absorptive capacity of the domestic capital market in order to avoid exerting undue pressure following the entrance of privatized entities. However, contrary to initial fears, privatization resulted in the deepening and broadening of the Malaysian stock market. By 1994, 19 privatized companies had been listed on the Kuala Lumpur Stock Exchange, accounting for about 24 per cent of the total stock market capitalization of $183.2 billion at the end of 1994. The ratio of market capitalization to nominal GDP had increased from 37 percentage points in 1974 to 175 percentage points in 1992, 3 percentage points in 1993 and 227 percentage points in 1994. The amou of funds raised had increased from $33.4 million in 1974 to $4.8 billion 1992 and about $5.0 billion for 1994. This clearly shows that t privatized entities had increased the number of stocks traded and h moved into new sectors such as airlines, shipping, telecommunicatio and electricity generation.

Although priority is given to local investors, foreign participation encouraged, especially in cases where foreign expertise is needed, wh domestic capital is insufficient to absorb the shares offered and where t export market is important. However, in certain projects which a considered strategic and of national importance, foreign ownership has be widespread to ensure that no one foreign party can exert und influence on the policies of the privatized entity.

To summarize, the major factors that ensured the success of t privatization policy are as follows:

(a) Commitment to reduce the financial and administrative burden the Government

In line with the emphasis of a private sector-led economy, t privatization policy effectively enhanced the role and responsibility of t private sector in economic and social development, thereby releasing mu needed resources to finance other priority projects. The size of t administration was rationalized and one of the more drastic steps tak was to impose a freeze in government sector jobs. However, this freeze d not include essential services like health and education.

(b) Pragmatic approach to the implementation of privatization

The Government encouraged private sector participation throu various concessions such as tax incentives and soft loans. This was ensure reasonable returns to the investors, particularly in the early sta of operation, and to ensure that consumers continued to enjoy fair a equitable charges.

(c) The seriousness and determination on the part of the Government see the success of the privatization policy

This commitment is evidenced by the acceptance of privatization the people as an entrustment of economic management of the nation the private sector. Privatized entities are still required to fulfil th social obligations and the various regulatory authorities ensure that such obligations are fulfilled.

(d) *Transparent process in the implementation of the privatization policy*

The key element to ensure such transparency is through a system of checks and balances by having officials from various ministries in the Privatization Committee headed by the Economic Planning Unit and undertaking relevant studies on the viability of the projects before privatization can take place.

(e) *Reward for initiative*

Apart from tendering privatization projects, proposals from the private sector are considered on a first-come first-served basis and for their innovative content. Once accepted, the Government provides exclusive negotiating rights to the proposer to implement the project. Such an approach has created intense interest and healthy competition in the private sector towards winning the right to implement potential projects.

(f) *Employee welfare safeguarded*

To ensure the necessary support from the employees of the privatized projects, general lay-offs for the first five years are not allowed, wages are much higher and opportunities are given to the workers to purchase the shares offered.

In addition to the above success factors, Malaysia's political and social stability, together with its openness and trade liberalization, contributed to the smooth implementation of the privatization policy. Comparatively low interest rates and high liquidity in the capital market provided low-cost capital so necessary to finance privatization projects.

Malaysia's success with its privatization policy should provide emerging economies with a model of growth led by the private sector. The Government must privatize in order to allow the country's entrepreneurial middle class to release the much-needed funds for expenditure which have been traditionally shouldered solely by the Government.

The widespread implementation of the privatization policy since 1983 has nurtured a strong indigenous entrepreneurial middle class and the active private sector participation in diverse economic activities, including areas which have been traditionally considered the domain of the public sector.

9. Human resources development

Malaysia's labour market or employment policy has, since 1971, not only been a critical part of overall growth policy but also a crucial input towards ensuring the success of the distributional targets of NEP and NDP. As such, it has acquired an importance beyond that of normal national employment policies.

The policy underwent several adjustments between 1971 and 1994 in order to bring about a continuing match between the changing demand for and supply of labour. The adjustments have been confined largely to modifications and changes to existing strategies and programmes.

The major objective of the labour market policy has, for a long time, been to expand productive employment at a rate sufficient to reduce prevailing levels of unemployment and, ultimately, to achieve full employment by the year 2000. A related objective has been to increase labour productivity and income, particularly those of workers in low-productivity, low-income occupations such as those in the agricultural sector. By 1993, however, when the economy reached a position of full employment, the latter objective had assumed greater importance.

The main strategies that have been utilized to create opportunities for productive employment have focused on the promotion of economic growth either by direct government participation in business activities or by stimulating and facilitating private sector growth. The sub-strategies for these include:

- The creation of public enterprises and government companies and the general expansion of the public service as part of the steps taken to implement the distributional programmes of NEP. This provided new job opportunities and enabled the indigenous population to gain experience in the business sector;
- The introduction of youth employment programmes, particularly in the form of public works, to alleviate high youth unemployment in the early 1970s;

- Revamping the structure of incentives to encourage new foreign and domestic investments. This included the introduction, in 1971, of the labour utilization relief measure. Aimed at encouraging employment creation, this measure is a tax exemption given to companies that employ at least 50 full-time paid workers;
- Opening of new land settlements in the 1970s and 1980s to create new jobs in agriculture and to raise rural incomes;
- The introduction of a package of countercyclical strategies to overcome the recession in the mid-1980s. This package included the following:
  - (i) Implementation of a labour-intensive, public works programme that involved, among other things, the construction of low-cost housing, roads and highways;
  - (ii) Making more agricultural land available for cultivation, including allowing the conversion of ex-mining land for agricultural purposes;
  - (iii) Generating more opportunities for self-employment, especially in urban areas, by relaxing the rules and regulations governing street trading.

Complementing the demand-creating strategies was a set of strategies designed to provide the needed supply of manpower. This includes:

- Further expansion of industrial and vocational training, beginning in 1971, with a special focus on producing high-level and skilled manpower. At the same time, a stronger orientation towards science and technology was introduced into the public education curriculum;
- Strengthening the administrative machinery for the dissemination of labour market information and monitoring the labour market to ensure labour market policies had led to the optimum utilization of manpower resources.

When there were indications in the late 1980s that the labour market was tightening up, several new strategies were introduced:

- Enhancing labour productivity and increasing jobs with higher skill content;

- Improving the efficiency of labour markets and increasing labour mobility in order to avoid skill mismatches, localized shortages and other labour market rigidities;
- Upgrading the education and training system in order to improve the quality and quantity of manpower and requiring the private sector to play a greater role in skill promotion as well as in strengthening linkages with public sector skill institutions. The establishment of the Human Resource Development Fund aimed at encouraging a training culture in the private sector was a step towards this end;
- Improving the wage system so as to enable wage movements to relate to productivity changes;
- Allowing the use of foreign labour on a short-term basis in certain sectors of the economy where shortages were acute.

The rapid growth of the Malaysian economy, and the accompanying emphasis given to job creation, resulted in a doubling of the number of employed persons from about 3.4 million in 1970 to 7.62 million in 1994 (table II.12). This growth enabled the labour market to absorb most of the increase in the labour force. Consequently, the unemployment rate dropped from 7.7 per cent in 1970 to just 2.9 per cent in 1994. This effectively means that Malaysia has achieved full employment. In line

Table II.12. Malaysia: population, labour force and employment
(Thousands of persons)

	1970	*1980*	*1990*	*1994*
Total population	10,776.9	13,879.4	18,013.2	19,795.4
Working age population[a]	5,631.0	8,103.0	10,589.8	11,747.9
Labour force	3,682.0	5,122.2	7,042.0	7,846.0
Employment	3,399.0	4,835.0	6,686.0	7,618.4
Unemployment	283.0	287.0	356.0	227.6
Unemployment rate (per cent)	77.0	5.6	5.1	2.9
LFPR (per cent)	65.4	63.2	66.5	66.8
Dependency ratio (per cent)	91.4	73.3	70.1	68.5

Source: Economic Planning Unit, Malaysia.

Note: LFPR = labour force participation rate.

[a] Persons aged between 14 and 64 years of age.

with the transformation of the economy, in which the manufacturing sector has assumed greater importance, the proportion of manufacturing workers to total employment increased from 9 per cent in 1970 to 25 per cent in 1994 while that for agriculture declined from 54 to 20 per cent over the same period (table II.13).

Table II.13. Malaysia: employment by sector, 1970 and 1994
(Percentage)

Sector	*1970*	*1994*
Manufacturing	9	25
Mining	3	1
Agriculture	53	20
Construction	3	8
Others	32	46
Total number employed	3,400,000	7,600,000

Source: Department of Statistics, Malaysia.

To sustain the present growth momentum, Malaysia will require continuous improvements in productivity, especially through human resource development. In 1994, the country was experiencing a tight labour market with an unemployment rate of 2.9 per cent and shortages of labour were felt in the major sectors of the economy. Such a situation will be more pressing in the near future with greater industrialization, when the demand for more skill-intensive occupations begins to escalate. The country will need more scientists, technologists and skilled, knowledge-based manpower.

The Government has implemented a number of programmes, together with various measures to strengthen training institutions, to provide skills training to meet the needs of industry. The Government's industrial training policy has been reoriented to allow for greater collaboration with the private sector. This shift will certainly reduce the financial burden of the public sector and also ensure that the types of skills training are relevant to the industries. The setting up of the Human Resource Development Fund is evidence of such a commitment. This Fund, which is financed through a levy imposed on employers, will seek to increase workers' skills, improve private sector involvement in training and, at the same time, curb the unhealthy trend of staff pinching among companies.

However, countries with a large pool of labour are more strongly placed with respect to the availability of human resources. With high unemployment, the supply of labour for accelerated growth is ensured. With appropriate training, the manpower requirements for skilled labour can be developed for emerging economies.

Apart from the supply side, the qualitative aspects of human resource development, particularly work ethics, should also be emphasized. Malaysia's workforce has assimilated a hardworking culture. The growing literate workforce is equipped with high cognitive skills, which provides it with the versatility to adapt and adopt new technologies. This accent on a hardworking culture is in direct response to new investments which demand a more knowledg-based and skill-based workforce in an ever-evolving development process.

Furthermore, Malaysia enjoyed prolonged industrial peace and did not encounter major industrial strife or disruptive loss in man-hours through industrial disputes. This can be attributed to the harmonious relationship existing between employers and the trade unions. Trade unions in the country are encouraged to be organized as in-house unions rather than industry-wide unions. Being in-house, such unions are better able to look after the welfare of workers and safeguard their rights through effective collective bargaining. Industrial disputes are resolved through negotiations and arbitration and, in cases where agreements fail, they are brought to the industrial courts. This process has promoted amicable resolution of industrial disputes.

D. INSTITUTIONAL DEVELOPMENT

Malaysia inherited the administrative, legal and legislative systems which were based on the British experience. This legacy has benefited the country through an effective and efficient bureaucracy. The bureaucracy must be able to formulate effective policies and possess the integrity to implement them fairly. The formation of the Economic Planning Unit under the office of the Prime Minister in the early 1960s enabled development planning to be carried out with authority through the successful use of an integrated inter-agency planning mechanism. The system of preparing medium-term to long-term plans in the form of five-year and outline perspective plans has been successful in garnering national support for national development. There has been national focus on getting the plans implemented. These plans have also assisted the private sector in understanding the Government's economic policies and in directing their efforts in tune with national goals. Malaysia has successfully implemented eight five-year plans and two outline perspective plans.

1. Administrative support: planning machinery

The conventional approach to planning requires an institutional structure that allows the formulation and implementation of global plans. Appropriate plans, programmes and strategies have to be formulated to guide the movements in the desired direction; their implementation has to be supported by the necessary rules, regulations and procedures to ensure adherence to the set process and minimize derailment along the way. These programmes, strategies and regulations need to be monitored and evaluated from time to time to take into consideration changes in the light of new circumstances. Hence, a good administrative machinery is essential.

In Malaysia, the "administration" was the most powerful and most prestigious set of structures in the society. Before independence, the Government was the most important institution and, in the absence of politicians, the administration was the Government. Since independence, that power has been shared with politicians, but many of the senior politicians were former administrators. Therefore, they had no desire to undermine the status or effectiveness of the bureaucracy, despite occasional grass-roots conflicts. It is fortunate that the Government established its administrative machinery well and today there is a strong, experienced, well-organized and open-minded administrative machinery in place. It is through this institutional set-up, particularly in terms of the planning and implementation machinery and processes, that has enabled the bureaucracy to guide economic and social changes successfully in Malaysia.

Parliament derives its powers from the Constitution, which stipulates legislative power for both the federal and the individual state governments. The Cabinet, headed by the Prime Minister, represents the highest policy-making body in the country.

Economic planning at the federal level is carried out by a number of institutions, including the Economic Planning Unit (EPU), the Implementation and Coordination Unit, the Malaysian Administrative and Modernization Planning Unit under the Prime Minister's Department, the Treasury and the Central Bank, as well as the planning cells of the various ministries and agencies. The responsibility and the authority for planning are vested in the Federal Cabinet, which is assisted by the National Development Planning Committee (NDPC), for which the EPU serves as a secretariat. NDPC, which is a committee of senior government officials chaired by the Chief Secretary to the Government, is responsible for formulating and reviewing all plans for national development and making recommendations on the allocation of resources. It also oversees the implementation of national development plans. The Inter-Agency Planning Group, in which the EPU, Treasury, Central Bank and Department of Statistics are represented, is central to the planning process, and provides inputs for policy formulation at the NDPC level (figure II.1).

The coordination of the development plans at the inter-state and inter-departmental levels is handled by ICU. At the state level, each state has its own State Economic Planning Unit whose role corresponds to that of EPU at the federal level.

2. *Administrative support: implementation machinery*

To operationalize the programmes and projects under each of the five-year plans, a macroeconomic framework is constructed and a five-year budgetary ceiling is determined in EPU which depend on three criteria:

- The role of Government and the private sector;
- The estimated Government revenue;
- The absorptive capacity of the economy.

Based on the budgetary ceiling that was fixed earlier, disbursement of the allocation on approved projects and programmes then takes place in the form of annual budgets conducted by the Treasury, which monitors the distribution of the allocation to the various sectors.

The approved projects and programmes under each plan are carried out under a Rolling Action Plan where the allocation for and timing of each project is spread throughout the five years (figure II.2). In the implementation of development plans and the monitoring of progress, the Government has adopted the "Operations Rooms" technique of keeping a vigil on the development efforts. The National Operations Room has access to information relating to the progress of development programmes at the state and district levels through its network linking all the state and district operation rooms.

Figure II.1. Malaysia: development planning machinery

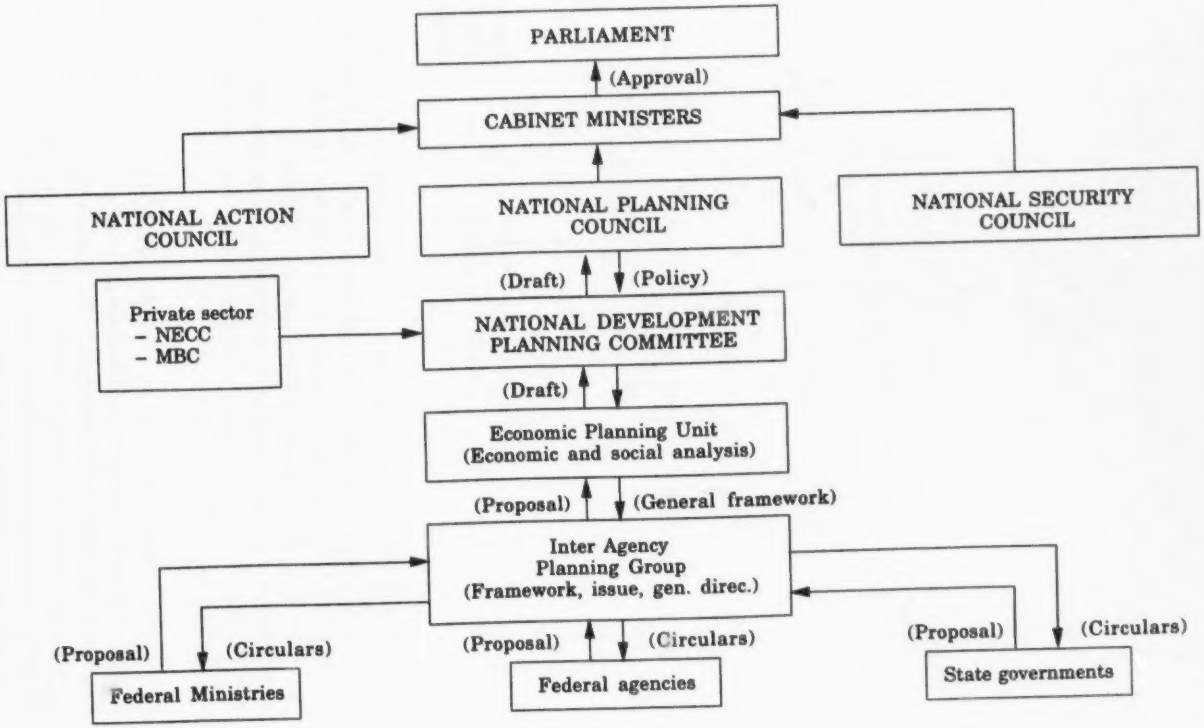
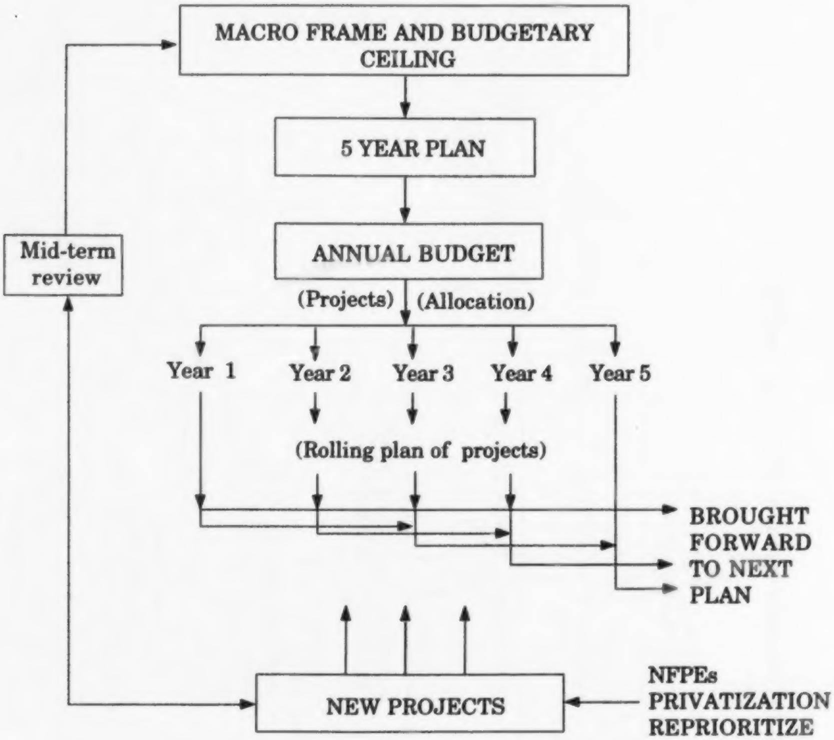

PARLIAMENT
(Approval)
CABINET MINISTERS
NATIONAL ACTION COUNCIL
NATIONAL PLANNING COUNCIL
NATIONAL SECURITY COUNCIL
(Draft)
(Policy)
Private sector
- NECC
- MBC
NATIONAL DEVELOPMENT PLANNING COMMITTEE
(Draft)
Economic Planning Unit
(Economic and social analysis)
(Proposal)
(General framework)
Inter Agency
Planning Group
(Framework, issue, gen. direc.)
(Proposal)
(Circulars)
Federal Ministries
(Proposal)
(Circulars)
Federal agencies
(Proposal)
(Circulars)
State governments

Figure II.2. Malaysia: operationalization of the five-year plan


MACRO FRAME AND BUDGETARY CEILING
5 YEAR PLAN
ANNUAL BUDGET
Mid-term review
(Projects)
(Allocation)
Year 1
Year 2
Year 3
Year 4
Year 5
(Rolling plan of projects)
BROUGHT FORWARD TO NEXT PLAN
NEW PROJECTS
NFPEs
PRIVATIZATION
REPRIORITIZE

Every third year of the five-year plan, a mid-term review is carried out to evaluate the effectiveness of policies, strategies, objectives and the progress of the development projects undertaken by various ministries and agencies. If necessary, the review will evaluate the requirements of new projects and programmes or re-prioritize existing projects. During a review, the macroeconomic framework is updated and the budgetary ceiling may be revised if necessary.

The incorporation of any new project which was not taken into account when the five-year plan was first formulated can easily be carried out using the rolling plan method. The financing of these new projects may come from the private sector (through privatization), the non-financial public enterprises or from prioritizing existing projects. In this way, any new unforeseen event affecting the welfare of the country can be addressed without disrupting the overall planning of the economy. The implementation mechanism also involves private sector participation. The "Malaysia Incorporated" arrangement aims at developing the synergy between the public sector and the private sectors through mutual support and cooperation in achieving national objectives. This arrangement was further strengthened with the formation of the Malaysian Business Council. The Council, chaired by the Prime Minister, and represented by key ministers, selected civil servants and prominent corporate leaders, provides an effective platform for communication with the Government. Such dialogues, which are frequently held, have resolved problems and bottlenecks and have served to provide feedback on a wide range of issues, including government policies, global markets and the general assessment of the health of the domestic economy. The "Malaysia Incorporated" policy is, therefore, a key strategy in the development of the nation and is a means to ensure the competitiveness of the national economy.

Malaysia's experience with development planning since the 1950s has demonstrated that the necessary institutions must be in place to facilitate the growth of the market system and a viable private sector. The Government's intervention is successful because of the existence of an effective and efficient bureaucracy that can carry through the process of planning and implementation after a unique process of consensus-building on national development goals and plans. While the mechanism for formulating and implementing development plans seems to suggest a rigid process, the actual process is, in reality, more flexible and pragmatic. The Government's pro-business policy stance and the constant interaction between the public and private sectors at all levels of the planning and implementation process makes the national objectives clear and easily understood by the major players, including both domestic and foreign private sector investors.

The strong administrative support available makes policy-making effective so that the plans that have been developed can coordinate the activities of economic agents effectively. In addition, the Economic Planning Unit reports directly to the Prime Minister and the investment expenditure of the five-year plan comes directly under the Unit to ensure that plans and programmes are supported by financial resources through the development budget. The main factor that is responsible for successful plan execution is the implementation mechanism that directly involves the Prime Minister. Plans are taken seriously and executing agencies are accountable to ensure projects are implemented. Shortfalls are not tolerated and severe reprimands are issued if there is not good reason for them. This sense of urgency and seriousness provides the motivation for successful plan formulation and execution.

E. LESSONS

The development strategies of the East Asian model have proved successful for the economies concerned. Malaysia had subscribed to the same strategies, albeit not in an autocratic way, but its economic performance has not been comparable in all aspects. Perhaps Malaysia's quest for a trinity of objectives – full employment, a high growth rate of GNP per capita, and more equitable distribution of income in a multi-ethnic environment – against a background of different natural resource endowments require examination of a second level of development strategies. Human resource development policies, technology policies and macropolicies will have to be looked at again from a different dimension. The constantly shifting comparative advantage between advanced industrial countries and the NIEs as well as between NIEs and developing countries in a new international economic environment make a fine-tuning of strategies a necessary prerequisite.

Discussions of the Malaysian success story should be superimposed on a dynamic international environment so that prospective strategies can be realistically formulated since they are essentially long-term in nature. Sustainability of such strategies must be matched at both the macro and sectoral levels. The increasing reliance on the private sector as the engine of growth further enhances this need. The overall consistency of stragegies must be provided because of the existence of inefficient markets in the least developed countries. Policies on "getting the prices right" alone will not suffice in the face of these markets and a very competitive international environment. Detailed formulations are needed in the model, and the role of the Government has to be clearly identified. Indications on the sequencing of strategies, as well as the proximate casual relationships, are important lessons that can benefit latecomers in getting the policy fundamentals right.

The Malaysian experience points important policy to several considerations. The Government must intervene to provide a good human capital base, a stable macroeconomic framework and a set of economic policies that has an export-oriented bias. Policies on wage restraint and productivity improvements support rapid export expansion. Macroeconomic policies which encourage rapid capital inflow and rapid domestic savings, as well as appropriate trade policies, are required to ensure swift transformation of economic structure. Government intervention should be focused on labour, investment, wage, productivity and price or incentives. Private sector initiative should be harnessed in private production and Government should not be involved.

The distinguishing feature of Malaysia as a successful economy is the hybrid of primary and industry sectors invloved in the expansion of exports. The relative shares of these two sectors should be balanced to incorporate the unique rich endowment of natural resources. This ensures that the agricultural sector still provides for the inflow of foreign capital because the bulk of the sector's contribution is from cash crops rather than staple crops. Emphasis on the rapid growth of internal demand is crucial to create the environment for the growth of more value-added activities that can be recycled within the domestic economy. This directly contributes to the absorption of labour to address the concern with growing unemployment in the early years and the need for highly skilled manpower for technology absorption in technology-intensive industries at this present time.

Those lessons on economic policies, however, depend on the initial conditions of the country concerned. The necessary condition in Malaysia's case is that the institutional framework for a market-based economy to function efficiently was already in place before the attainment of self-rule. With independence, the focus on policy-making, development and equitable distribution of the fruits of economic progress has made it imperative for government intervention. Malaysia has been fortunate to have enjoyed political and social stability for a sustained period. Although no causal relationships can be established, Malaysians like to believe that the policies that have been implemented involved society at large and that the citizens have enjoyed a better standard of living and quality of life as a result. The pre-eminence of the national agenda for Malaysian society has, in turn, supported the growth of a national consensus in the quest for development.

The vigorous pursuit of growth with equity over the last 25 years has demonstrated that there is no big trade-off between growth and equity. Instead, economic growth was sustained at a high level and society enjoyed the benefits from poverty alleviation and a rapid growth in the entrepreneurial middle class as a result of income distribution policies. The large continuous investments in social and physical infrastructure have developed the fundamental strengths in human resources and infrastructural facilities to support economic activities and enhance the quality of life.

Malaysia has had a long and successful experience in reducing poverty, expanding productive employment, strengthening social integration and in generally bringing about rapid socio-economic development. The experience is probably unique to Malaysia. Nevertheless, its broad features and underlying principles and strategies are probably relevant to other developing countries as well. In particular:

- Peaceful co-existence among ethnic or other groups in society, as well as close cooperation among ethnic-based political parties, is crucial if there is to be political stability and if socio-economic development is to proceed unhindered by domestic strife;
- The inherent tendency of a plural society to disintegrate, or at least compartmentalize itself into competing or hostile sub-groups, can be countered and contained through a mult-pronged, coordinated and persistent attack on it;
- Much of the success, particularly in poverty eradication and expansion of productive employment, was made possible because there was almost continuous and rapid economic growth;
- Pure economic growth alone cannot guarantee social harmony, particularly in a plural society. It must be balanced by a strong and real emphasis on equitable distribution of development benefits. Governments have to ensure that this takes place;
- For most social problems, a major solution, or prerequisite to a solution, is education and training of the affected groups;
- Public policies must not only be relevant but also innovative and flexible to enable them to be more effective in overcoming social problems which are typically complex and dynamic in nature. The special unit trust scheme for the hardcore poor in Malaysia is an example of such a policy;
- Governments must genuinely be people-based and ensure that there is broad participation in policy making so that public policies are based on a national consensus, truly address the people's needs and therefore are supported and have a better chance of succeeding;
- Governments must be caring, particularly for groups such as the poor, elderly and disabled, who otherwise would be neglected or not adequately dealt by NGOs and others;

- NGOs and the private sector can and should be encouraged to make their contributions towards the minimization of social problems and should not be regarded as competitors of government agencies.

The most important lesson in the Malaysian experience is that a growth strategy led by the private sector is most effective. The recent experience with rapid growth is the manifestation of a successful privatization policy which increases business confidence and encouraged investment growth, including strong foreign investment. The liberal trade and investment policies have enabled multinational corporations to engage in international best-practice operations which act as benchmarks for domestic industries that were given a head start through moderate levels of protection. The proper balance to allow for the coexistence of domestic and foreign-owned industries is another important lesson.

Finally, the prudent, flexible and pragmatic role of the Government has been a crucial factor. Bold measures must be made once the market forces have demonstrated that certain strategies and policies no longer apply when circumstances are changed. Any shift in strategy or policy must be viewed as permanent, thereby providing the certainty and stability conducive to eliciting a favourable response from investors and exporters.

F. CONCLUSION

The Malaysian success story is not a result of any single policy but different policies applied at different times. The Government distinctly played the leading role in structural adjustment, particularly in influencing savings, investment and financial policy. These policies were instituted in an environment which had some favourable preconditions. World trade was growing rapidly and there was easy access to markets in developed economies. There was also a ready pool of trained and disciplined manpower. Military expenditure in the early stages was very low and foreign aid provided capital inflows.

The transferability question for another country is no longer valid in a changed environment faced with a different set of initial conditions. On very broad overall strategies and policy regimes, such as export-led growth orientation, floating exchange rate regime, liberalization and so forth, Malaysia has to some extent adopted these. However, at the present level of development, the focus should be on second-level strategies and policies.

On a comparative basis, the significant differences in terms of economic performance can be seen in the economic structure, the composition of manufactured exports, the types of investments that the high savings are channelled into, the richness in natural resources, skilled manpower and role of the public sector. Meticulous analysis of these differences and the development of a strong internal demand through rapid increases in income will provide the options available to the nation in a long-term horizon. In the medium term, complete reliance on market forces to allocate resources will not accomplish the longer-term objectives of the nation. As demonstrated by the strategies of the East Asian economies and currently adopted by the United States of America and the European Union, the Government has a definite role in charting an economy's future directions. However, this role should not encompass involvement in private production which stifles the private sector. Rather, the Government should focus on the framework of broad macroeconomic policies, as well as active intervention in fostering high savings and investments that are channelled into high value-added activities, the provision of adequate and efficient physical and social infrastructure, including institutions, the development of excellent international marketing linkages for continued export growth and the provision of a social welfare programme for the truly disadvantaged groups that does not discourage savings and work incentives.

In essence, the Government must take positive measures to improve the factors of production while providing a conducive environment for the market mechanism to operate in the private domain.

Table II.14. Malaysia: macroeconomic indicators

(M$ billion)

National product	1992 Value	1992 Per cent change	1993 Value	1993 Per cent change	1994 Value	1994 Per cent change
Gross domestic product, 1978 prices	93.1	7.8	100.8	8.3	109.7	8.7
Agriculture, forestry and fisheries	15.5	4.3	16.1	3.9	15.9	-1.3
Mining and quarrying	8.1	1.6	8.0	-0.5	8.2	1.5
Manufacturing	26.9	10.5	30.3	12.9	34.7	14.6
Construction	3.6	11.7	4.0	11.2	4.6	15.0
Services	40.7	8.9	44.8	10.0	48.8	9.0
Gross national product, current prices	139.8	13.9	154.8	10.7	176.3	13.9
Gross national product, constant prices	87.9	7.5	95.5	8.7	104.1	8.9
Aggregate domestic demand	91.9	4.4	100.4	9.2	113.6	13.2
Private expenditure	67.6	4.0	72.5	7.2	81.3	12.2
Private consumption	45.4	4.4	47.8	5.3	51.6	8.0
Private investment	22.7	6.6	24.8	8.9	29.4	18.7
Public expenditure	24.3	5.6	28.0	15.0	32.3	15.5
Public consumption	13.5	4.0	14.9	10.6	16.4	10.1
Public investment	11.1	11.2	13.1	18.0	15.8	20.0
Gross national savings (percentage of GNP)		32.0		32.7		33.9
Balance of payments						
Merchandise balance	8.6		8.2		3.7	
Exports	100.9		118.4		148.6	
Imports	92.3		110.2		144.9	
Services account (net)	-13.6		-15.0		-15.7	
Current account balance	-4.7		-6.3		-11.6	
Current account balance (percentage of GNP)	-3.3		-4.1		-6.6	
Central Bank reserves (net)	47.2		76.4		68.2	
Reserves as months of retained imports	5.6		7.8		5.3	
Prices						
Export price index	4.2		1.0		4.0	
Import price index	0.7		1.5		2.6	
Change in terms of trade	3.5		-0.5		1.3	
CPI (1994 = 100)	4.7		3.6		3.7	
PPI (1978 = 100)	1.1		1.4		4.9	

Source: Bank Negara Malaysia.

Note: CPI = consumer price index; PPI = producer price index.

III. THE DEVELOPMENT EXPERIENCE OF SINGAPORE: LESSONS FOR THE ECONOMIES IN TRANSITION IN INDO-CHINA*

A. INTRODUCTION

When Singapore was forced out of Malaysia in 1965, the general feeling was one of doom and gloom. The then Prime Minister, Mr Lee Kuan Yew, shed tears when he announced the sad news over television. The major concern was how a small city state would survive with its hinterland cut away. The grave concern stemmed from a possible loss of entrepôt trade, the major source of Singapore's income, as well as the dire economic and political situation that Singapore was facing. Internally, unemployment was above 13 per cent, with the population growing at a rate of 3.3 per cent, and the economy was performing badly, with widespread strike action taken by unions under the control of communists who wanted to overthrow the democratically elected government. In 1961, there were a total of 116 strike actions resulting in 410,889 man-days lost (table III.1). Subsequently, the number of strike actions was significantly reduced over the years, with none occurring in 1988. Equally serious was the great division among the people along ethnic lines which manifested itself in occasional racial riots. Many expert observers would have ruled out any hope of significant economic development as it would be practically impossible without a united people. It is not far-fetched to say that Singapore was on the verge of political turmoil and social disorder that were likely to bring about its total collapse.

Externally, the situation was no better, with Singapore being located in a region classified as the most turbulent in the world and being termed the "third China" in a predominantly Malay region. Political instability also made Singapore less attractive as an investment site for foreign companies. The British military and naval presence in Singapore, which was also a major source of income for the island state, afforded protection but this could not be taken for granted, and this fear was soon realized in 1967 when Britain announced its military and naval withdrawal as a consequence of its East of Suez policy.

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* This paper was prepared by Mr Ng Chee Yuen, consultant to the Development Research and Policy Analysis Division, ESCAP. Mr Ng is Senior Fellow, Institute of Southeast Asian Studies, Singapore.

Table III.1. Singapore: industrial stoppages, 1961-1988

	Number of stoppages	*Workers involved*	*Man-days lost*
1961	116	43,584	410,889
1965	30	3,374	45,800
1968	4	172	11,447
1977	1	406	1,011
1986	1	61	122
1988	0	0	0

Source: *Singapore Yearbook of Labour Statistics*, 1968 and 1988.

However, against all expectations, Singapore has developed from strength to strength since separation from Malaysia. With the exception of cyclical downturns in every decade (1964, 1975 and 1985/86), Singapore's annual average real economic growth rate has been sustained at more than 6.4 per cent, with most years close to or at double-digit level (table III.2). This high economic performance of Singapore has been achieved through a remarkable economic restructuring that has transformed Singapore into what it is today (tables III.3 and III.4). Presently, Singapore has become the great success story to be emulated by the less developed countries. How did Singapore achieve thist? What lessons can we draw from the Singapore experience? Can the same strategy and policies be duplicated in other countries? These are some of the questions that this paper will look at, with special reference to their relevance and applicability to the Indo-Chinese countries.[1]

The paper begins with the identification of constraints and favourable conditions facing Singapore since its separation from Malaysia. This is necessary to understand better the strategy and accompanying economic, political and social policies given the narrow options open to Singapore. Following this is a brief description of the role of the state and the bureaucracy, particularly how the necessary incentive systems and

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[1] With a land size of 620 square kilometres (depending on the tide) and a small population of less than 3 million, no rural sector, devoid of natural resources as even sand and water have to be imported, and a short history, what is applicable to Singapore may not be very relevant to the Indo-Chinese countries. However, certain principles may be universal and therefore useful to these countries. In this regard, it is not the purpose of this paper to explain the successful industrialization of Singapore through strategic economic factors such as high domestic savings and capital accumulation, a well-educated and trained workforce, efficient allocation of resources and equitable distribution of income. These have been well documented in many works on Singapore. The purpose of this paper is to go beyond the usual major economic factors to explain the root cause of Singapore's successful development.

Table III.2. Singapore: gross domestic product and gross domestic savings, 1965-1990

Average annual growth rate of gross domestic product

1965-1980	*1980-1984*	*1985-1990*	*1986*	*1987*	*1988*	*1989*	*1990*
10.1	8.5	6.4	1.8	9.4	11.1	9.2	8.3

Gross domestic savings as a percentage of gross domestic product

1965	*1986*	*1987*	*1988*	*1989*	*1990*
10.0	38.9	40.4	43.5	44.1	44.9

Source: World Bank, *World Development Report 1991*, and Asian Development Bank, *Key Indicators of Developing Member Countries of ADB*, July 1991.

Table III.3. Singapore: economic restructuring, 1965-1989
(Percentage)

Agriculture		*Industry*		*Manufacturing*		*Services*	
1965	*1989*	*1965*	*1989*	*1965*	*1989*	*1965*	*1989*
3	0	24	37	15	26	74	63

Source: World Bank, *World Development Report 1991*, Economic Development Board *Annual Report 1985/86*, and Asian Development Bank, *Key Indicators of Developing Member Countries of ADB*, July 1991.

Table III.4. Singapore: restructuring of gross domestic product by sector, 1960-1990
(Percentage)

	1960	*1970*	*1980*	*1990*
Manufacturing	11.7	19.3	29.5	9.1
Trade	35.3	29.6	18.9	17.5
Financial and business services	11.1	13.9	20.5	32.4
Transport and communications	14.0	11.0	12.0	14.2
Others	27.9	26.2	19.1	26.8

Source: World Bank, *World Development Report 1991*, Economic Development Board *Annual Report 1985/86*, and Asian Development Bank, *Key Indicators of Developing Member Countries of ADB*, July 1991.

institutions and a conducive investment environment were put in place to translate the continuous development of human resources into productive activities in a mixed economy.

B. CONSTRAINTS

On separation from Malaysia in 1965, Singapore had a land area of 581.5 square kilometres and a population of about 1.7 million. Although, today, land area and population have increased to 620 square kilometres and 2.7 million respectively, Singapore is still small compared with other countries. The physical size of Singapore limits its ability to support a sizeable population and land-intensive pursuits such as agriculture and heavy industry. Naturally, Singapore has a small domestic market where high learning costs cannot be absorbed because of the absence of a secure home base. This has deterred the emergence of domestic industrial entrepreneurs and forced a heavy dependence on multinational corporations. Singapore has to specialize in order to enjoy economies of scale and must export. The need to export is also dictated by the scarcity of natural resources; these have to be imported. In a sense, the growing nationalism in neighbouring countries, which increasingly embarked on direct trade, may also be included as a constraint as these countries have been Singapore's historical hinterland. However, it should be noted that not all limits are immutable. Some may be offset by appropriate technology and modification of social norms and organization; and others may be turned into an advantage.

C. FAVOURABLE FACTORS

One factor of critical importance that comes to mind is Singapore's strategic geographical location, coupled with a good natural harbour. Singapore is fortunate to be located within a resource-rich and well-populated South-East Asian region, at the major crossroads between the developed West and the developing East. These factors not only induced the British to make Singapore its military and naval bases but also helped in the development of Singapore as an entrepôt centre. Consequently, ancillary activities such as storage, processing, banking, insurance, transportation and communications flourished as Singapore developed as an entrepôt centre. These activities undoubtedly provided knowhow and effective training grounds for subsequent economic diversification. More importantly, these activities created a great number of commercial entrepreneurs and established a well-developed physical and commercial infrastructure which proved exceedingly useful for Singapore's industrialization and export-oriented strategies for manufacturing.

Smallness also has its own advantages. A small society is more cohesive and it can be more easily and efficiently governed. In addition, Singapore's smallness has given it greater manoeuverability in international trade as it attracts less attention and therefore reduces the possibility of trade retaliation.

Finally, the timing of economic growth through export expansion has also been fortuitous in the sense that the external environment was conducive to growth in international trade and investment.

D. DEVELOPMENT STRATEGY

The concept of strategy implies purposeful direction over an extended period; and the essence of development strategy is to identify and overcome by proper policies those crucial bottlenecks which impede development. Therefore, in a broad sense, to the extent that Singapore is a paternalistic State which effectively manages both the domestic and the international environment towards competitive growth, through an approach which has been sustained in a sufficiently coherent manner throughout the long rule of the People's Action Party (PAP), it may be said to have a development strategy. And the essence of Singapore's development strategy is its politico-economic combination: prudent and pragmatic, but selectively liberal, economic management and political engineering towards a regime that provides the State with sufficient, but accommodating, authority.

Taking into consideration the constraints and favourable factors described earlier, the Singapore economy is necessarily open and trade-dependent. The main thrust of its strategy is to achieve optimal growth by improving its competitive edge through the maintenance of a free enterprise system. The architect of the Singapore economy, Dr Goh Keng Swee, noted:

> It requires no less than the removal from the economic system of all the harmful encumbrances which have accumulated through the years; in other words to restore to the free enterprise system its true source of strength and flexibility which is based on the freedom of businessmen, in competition with all others, to meet the needs of the country by providing goods and services in accordance with the free market mechanism and not in accordance with bureaucratic controls (Goh, 1977, p. 59).

He also stated:

> ...despite the changes in demographic structure and the introduction of representative government the economy of Singapore works in much the same way as it did under British management. True, there has been a change in the objectives of economic policy – to expand industry rather than trade and shipping. It is also true that Singapore now serves not merely the immediate region, but looks to a worldwide market for its manufactures. Yet, the basic thinking and philosophy underlying this policy is essentially unchanged. And this is that Singapore must excel in business and whatever it attempts. And government policy, now as before, must be directed to the support of this pursuit of business excellence. The colonial governors did this in trying to provide the most efficient trading and shipping services, and today we are trying to do the same for the manufacturing industry, without, at the same time, discarding the traditional entrepôt trade. Whether for trade or industry, Singapore has found, through experience, that the free enterprise system, intelligently supported, gives it that degree of flexibility which has ensured its survival and prosperity, through its ability to adapt quickly to changing circumstances (Goh 1977, pp. 16-17).

Although Singapore continued in its efforts to improve its entrepôt trade, the simple processing and other ancillary activities associated with this trade were not sufficient to absorb the pool of unemployed and sustain long-term economic growth when faced with a rapidly growing population and the increasing trend of neighbouring countries to promote direct trade. Singapore needed to industrialize and to promote manufactured exports. However, there were scarcely any natural resources to exploit or any indigenous industrialists to finance such activities. Singapore could, of course, borrow heavily from external sources but the task seemed daunting and unattractive. The alternatives for this city-state seemed to narrow down to the option of attracting subsidiaries of multinational Corporations which not only possessed the technical know-how and financial resources but also had easy access to export markets.

Attracting foreign investment from multinational Corporations is, however, not an easy task. It requires a conducive environment that includes, among other factors, political stability, adequate infrastructure, a ready supply of trained labour, industrial peace and wage stability, and conducive regulations consistent with a free enterprise system. All these factors require the active participation of the government, the cooperation of the unions and effective implementation of state policies by the bureaucracy. Naturally, like other countries, Singapore did not want to see an over-dependence on multinational Corporations. Thus, in the absence of industrial entrepreneurs, the underdevelopment of the capital market and the private sector's inability to mobilize financial resources, the reluctance or inability of the private sector to invest in sectors or industries with unusually high commercial and non-commercial risks and to implement investment projects which require large amounts of investment capital, the State had to play an active role in the establishment of government-linked companies (Ng and Wagner, 1989, 1991).

E. INSTITUTIONAL REQUIREMENTS FOR A MARKET ECONOMY

One of the first steps that the PAP Government took, when it came to power in 1959, was to establish a "clean" government and an effective civil service to execute the array of policies and regulations to achieve economic prosperity, without which the Government could not be an effective instrument of policy. Corruption is looked upon as a serious impediment not only to development and modernization but also to the principle of shared growth on which the legitimacy of the regime has been based. It is arduously dealt with by the enactment of effective laws and the establishment of the Corrupt Practices Investigation Bureau, which reports directly to the Prime Minister. An effective civil service is ensured in Singapore by insulating it from political pressures, thereby facilitating its ability to formulate and implement policies in keeping with national goals. This insulation has enabled the civil service to introduce and sustain rational economic policies, and some vital wealth-sharing mechanisms. Singapore also has a very elaborate process for the recruitment and retention of competent civil servants to formulate effective policies with the integrity to implement them fairly. Broadly, the principles used are that recruitment and promotion must be merit-based and highly competitive; total compensation, including pay, perks and prestige, must be competitive with the private sector; and those who make it to the top should be amply rewarded (World Bank, 1993). In this manner, the PAP Government has been able to build an efficient and honest civil service that shares the same nation-building philosophy and development goals of the political leaders.

To make it easy and profitable to set up businesses in Singapore, increasing financial resources were not only directed to ensure the maintenance of adequate infrastructure at minimum cost with maximum efficiency, but also to establish industrial estates to reduce set-up time and costs. The focus and resources allocated to the development and maintenance of efficient infrastructure in transport and communications, for example, helped significantly in reducing the running costs of businesses in terms of time, money and reliability, thereby improving the competitive edge of industrial enterprises competing in the international market place.

In this regard, the Economic Development Board (EDB), established in 1961, played a critical role in attracting foreign investments, in changing the priority to the promotion of skill-intensive and technology-intensive industries and in spearheading the industrial drive. The efficiency and success that EDB achieved in setting up the Jurong Industrial Estate and other industrial estates have given this institution such a good reputation that other countries are seeking its advice on similar endeavours. Many observers have said that industrialization in Batam would have been less impressive if it had not been for the direct involvement of EDB in setting up and running the Batam Industrial Estate.

To ensure industrial peace and wage stability, the Government restructured the labour force to suppress radical activity. Two important pieces of legislation, the Employment Act and the Industrial Relations (Amendment) Act were passed in 1968.[2] The tripartite National Wages Council (NWC) was also established to institutionalize a consultative relationship between government, management and labour, and thereby avoid antagonistic wage negotiations. Each year, NWC reviews wage adjustment guidelines based on productivity increases and the general performance of the national economy and, although recommendations are officially non-binding, the Government has consistently given its endorsement, and business and labour use them as wage settlement benchmarks. The effectiveness of this system was evident during the recession of 1985/86 when labour accepted a pay cut of about 12 per cent. Its effectiveness can also be gauged by the significant reduction in man-days lost due to strike actions from 410,889 in 1961 to 0 in 1988 (table III.1). Workers are also organized into cooperatives with a stake in the economy. The National Trade Union Congress, in addition to being an organizer of labour, is also a provider of goods and services. It has established cooperatives such as the Fairprice Supermarket Cooperative and the Comfort Taxi Service. These cooperatives are so successful that some observers have noted that:

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[2] For a detailed discussion of the rationale and impact of these two Acts, see Goh (1977), pp. 9-10.

> By the end of 1991, Comfort had accumulated a surplus nearly five times its initial government loan. Much of that goes to buy new cabs and other capital equipment to upgrade service. The rest goes to dividends (10 per cent) and to fund educational, social, cultural, and safety net programmes for the benefit of Comfort's members and their families. Comfort's next step? A share issue on Singapore's stock market. Recently, Comfort announced plans to issue shares to increase its capital base and expand operations. Most of the proceeds will be used to expand a new joint venture in China (World Bank, 1993, p. 166).

To ensure are adequate supply of trained labour, increased focus has been given to technical education in schools and a number of vocational institutes have been established with generous donations of both machinery and experts by developed countries such as Japan, Britain, France and Germany. The important issue of human resource development is discussed in more detail in a later section. In this section, it is sufficient to note that, by 1978, Singapore faced a serious labour shortage of both skilled and unskilled categories, despite the rapid increase in the female labour force participation rate, which increased significantly from 30 per cent in 1970 to 48 per cent in 1985 (Lim, 1988, p. 143, table 6.2), and liberal laws for migrant workers which resulted in 12 per cent of the labour force being foreign workers in 1970. This shortage of labour induced the high-wage policy of 1979, where emphasis was given to the adoption of labour-saving methods such as mechanization, computerization and automation.

To promote political stability and establish regime legitimacy through the principle of shared growth, Singapore has intervened heavily in the housing market to win the support and cooperation of non-elites. To do this, the Housing and Development Board was formed in 1960. It embarked on a massive programme to provide low-cost, high-rise housing to solve the acute housing shortage. Later, the Housing and Urban Development Corporation was also established to provide housing to persons in the middle-income group. In Singapore, the provision of public housing is one of the few activities where subsidies are given. This exception has been made for the provision of public housing because it not only creates urgently needed meaningful employment that effectively reduces inequality and minimizes social unrest, but also helps to hold down wage demand, thereby subsidizing labour-intensive manufacturing industries. It also increases the average Singaporean's stake in the nation and gives its citizens greater motivation in establishing national defence through national service. Today, about 80 per cent of the population live in public housing, with more than 90 per cent owning their units.

To ensure sufficient inducement for foreign investment, Singapore also offers fiscal incentives in the form of pioneer industry status carrying exemptions from income tax, accelerated plant depreciation, concessions on interest for foreign loans and royalty payments, and other incentives. For export-oriented industries, concessionary tax rates may even be extended after the expiry of pioneer status.

As a consequence of these fiscal incentives, as well as political and macroeconomic stability, an honest and efficient civil service, the availability of skilled labour, an adequate and efficient infrastructure, and industrial peace and wage stability, Singapore has been able to attract an increasing number of multinational Corporations from all parts of the world. As shown in table III.5, between 1973 and 1989, the multinational Corporations based in the United States have been the largest foreign investors, followed by those based in Japan, the United Kingdom, the Netherlands, the Federal Republic of Germany and France. As shown in table III.6, industries have been concentrated in petroleum and petroleum products, electrical machinery and electronic apparatus, appliances and supplies, industrial chemicals, general machinery, fabricated metal products and transport equipment manufacturing.

This state-centred approach, which stresses the role of the State in effectively planning and implementing direct control over the industrialization process, calls for the State to be "autonomous" and "strong" vis-à-vis both external linkages with the advanced countries and internal relations with the local elites (White, 1984, 1988). Within the confines of Singapore's paternalistic culture, authority is expected to combine, with grace and benevolence, both elitism and sympathy: the ideal demands that leaders possess strong personal character. The patrimonial heritage also assists by elevating the prestige of bureaucrats so that competence can be stressed. The role of the State is proactive and accepted as long as its dominance produces social benefits. State intervention in economic activities is expected and has contributed to social stability.

However, benevolent paternalism is not sufficient to produce a strong State. The legitimacy of the rulers hinges on their ability to "deliver" broadly. The broad-based PAP Government has effectively demonstrated the ability to insulate state planning from particularistic

Table III.5. Singapore: foreign manufacturing investment by country of origin, 1973-1989

($ million)

	1973	*1977*	*1981*	*1985*	*1989*
United States	992	1,366	2,606	4,656	7,143
Japan	237	633	1,396	2,943	6,600
Europe	954	1,407	3,414	4,480	6,582
European Community	912	1,324	3,159	4,172	6,172
United Kingdom	390	566	1,396	1,796	2,418
Netherlands	381	571	1,421	1,663	2,583
Federal Republic of Germany	102	130	187	245	458
France	17	21	82	190	415
Switzerland	31	38	115	129	145
Others	476	739	966	1,081	1,166
Total	2,659	4,145	8,382	13,160	21,490

Source: Economic Development Board, *Annual Report*, 1985/86 and 1990/91.

Table III.6. Singapore: foreign investment in manufacturing by industry group, 1973-1984

($ million)

Industry group	*1973*	*1977*	*1981*	*1985*	*1989*
Food, beverages and tobacco	93	143	780	1,226	1,743
Textiles	132	152	296	176	198
Apparel and footwear	43	103	257	338	506
Leather and rubber	34	38	69	94	111
Wood and cork	137	162	433	448	437
Paper and its products	35	47	556	908	1,331
Industrial chemicals	64	63	258	2,182	2,815
Other chemicals	62	113	240	497	634
Petroleum and its products	1,267	1,617	3,622	4,430	5,448
Plastic products	32	64	292	529	746
Non-metallic mineral products	43	83	294	739	786
Basic metals	27	54	188	342	434
Fabricated metals	176	124	842	1,427	1,958
General machinery	176	124	842	1,259	1,790
Electrical machinery	249	505	1,734	3,377	7,633
Transport equipment	125	287	1,292	1,819	2,130
Precision equipment	109	172	165	249	414
Other manufactured goods	31	33	172	218	371
Total	2,659	4,145	12,443	20,259	29,513

Source: Economic Development Board, *Annual Report*, 1985/86 and 1990/91.

Note: Foreign investment figures represent the cumulative gross fixed assets, including local investment.

pressures and to deliver the goods. This regime has not only gained the capacity to pursue strategic goals, but also legitimacy among the non-elite, excluded sectors, making compliance less demanding of state resources which are then freed for other purposes.

Thus, Singapore's economic success is largely due to the ruling PAP. In particular, the Singapore experience has shown that the single-party, corporatist regime, propped up by the legislature, has been an effective means for organizing and institutionalizing political participation without politicizing the planning process. Although multinational Corporations and the global economic system impose certain constraints, there is a degree of autonomy from foreign and domestic groups which is sufficient to permit the elites and politically insulated technocrats to formulate coherent development strategies within this framework. Singapore's turn towards export-led growth and an open policy towards foreign investment rests on several political factors. The consolidation of single-party rule and the exclusion of the left allowed former Prime Minister Lee Kuan Yew and the economic bureaucracy to pursue a pragmatic approach to industrialization. This was supplemented by the collaborative restraint of labour, through the tripartite NWC, so that wage increases would not outstrip productivity increases. In essence, there are two main instruments for the implementation of development strategy: an effective and strong state apparatus and the establishment of a series of mechanisms ensuring political legitimacy, social integration and social control in the relationship between the people and the party-state.

F. MACROECONOMIC MANAGEMENT

Singapore practises conservative macroeconomic management to achieve high economic growth, low inflation and full employment. It maintains macroeconomic stability by adhering to conservative policy prescriptions such as holding inflation low, a balanced budget, manageable internal and external debts, and quick resolution to crises. This is not new but a follow-up of the successful fiscal conservatism of the colonial era. This conservatism has facilitated a realistic exchange rate and low inflation, which have helped export performance. Self-imposed constraints on fiscal policies and borrowing, including balanced budget practices and various institutional checks, have generally contributed to fiscal discipline and low inflation. Except for short periods, the inflation rate has generally been kept at below 4 per cent.

Although Singapore adheres to the principle of a balanced budget, in practice the current accounts of both the Government and the statutory boards have generally been in surplus since 1965. Only under very unfavourable conditions would budgetary expenditure be increased to maintain steady growth. Singapore has generally refrained from borrowing abroad or seeking foreign aid. As has been noted, "by and large, the government has adopted very thrifty and conservative budgetary practices with minimum resort to external borrowing." (Lim, 1988, p. 363). Internal borrowing and government savings accumulated through prudent fiscal policies are used to finance infrastructure development, public housing, education, and parks and recreation facilities that enhance the quality of life. Consequently, the shares of internal and external debts are as follows: "The domestic component was 90.9 per cent in 1966 and 98.1 per cent in 1985 with an average annual growth of 22.9 per cent over the period. External debt which reached $1,018.2 million in 1978 declined to $596.3 million in 1985." (Lim, 1988, p. 363)

Singapore also practises swift and flexible responses to shocks whether they are the consequence of changes in the external environment or the result of inappropriate or wrong policies. For instance, in the 1985/86 recession, when economic growth fell from 8.3 per cent in 1984 to -1.6 per cent in 1985, partly as a consequence of Singapore's high wage policy, which eroded its competitiveness, and partly the result of sharp falls in commodity prices, which affected the economies in the region, the Government immediately set up the high-powered Economic Committee not only to devise an integrated package to reverse the high wage policy and restore Singapore's competitiveness, but also to rethink Singapore's economic growth strategy. This exercise resulted in:

- A reduction of the employers' share of Central Provident Fund contributions from 25 to 10 per cent, effective 1 April 1986;
- An immediate personal income tax rebate of 25 per cent for 1986. From 1987, the top marginal rate was reduced from 40 to 33 per cent and the lowest rate from 4 to 3.5 per cent. For the lower income group, the rebate on tax payable for the first S$10,000 was raised from 10 to 15 per cent;
- A cut in corporate tax from 40 to 33 per cent, effective from 1987 onwards;

- A temporary reduction of in the Skills Development Fund Levy from 2 to 1 per cent;
- An extension of the Economic Development Capital Investment Allowance to service and trading companies;
- An increase in the rebate to industrial and commercial properties from 30 to 50 per cent from 1 July 1986, with the proviso that the benefit be passed fully to tenants;
- A wage freeze for a period of at least two years.

These measures, coupled with the depreciation of the Singapore dollar, which boosted exports, and significant cuts in running costs, such as rentals and utility charges, led to the Singapore economy recovering rapidly, resulting in 8.8 per cent growth in 1987. Thus, macroeconomic stability, which encouraged private savings, investments, exports and growth, is a key element to economic success in Singapore.

G. HUMAN RESOURCES DEVELOPMENT

One area to which Singapore has given top priority, like other high-performing Asian countries, is human resource development. Singapore invested heavily in education and training, which are critical to facilitating and upgrading manpower resources to achieve higher productivity growth and competitiveness. Education is necessary to create meaningful and commercially viable skills and technology. A nation's stock of specialized and skilled professional and technical personnel is vital and its importance increases as the economy advances. This is particularly so for Singapore since it has to concentrate on the development of business services which demand highly trained personnel in management.

The important thing to note here is that the end result is highly dependent on the rate of investment in human resource development, the desired standard of performance and how well the institutions involved in creating the factors are run. In Singapore, the general philosophy of striving for excellence is an attempt to achieve optimal returns from such investments. This is also ensured by the openness of the Singapore economy, which is subjected to competitive pressures. A number of local competitors (including multinational corporations) in vigorous competition stimulate the rapid development of skilled human resources. The education system is extremely competitive and the emphasis is on mathematics, science and the training of skilled technicians. Despite this emphasis, skilled human resources are still in short supply and Singapore has resorted to immigration to supplement the shortage. These efforts have enabled Singapore to sustain the skill upgrading process and its productivity growth has increased continuously.

H. FINANCIAL RESOURCE MOBILIZATION

Since 1965, rapid growth in savings and investments has accompanied economic progress in Singapore. As the paper noted earlier, Singapore has always refrained from seeking foreign aid or external borrowings, which implies that rapid economic growth has been generally facilitated by a combination of foreign direct investment and available domestic funds generated through both public and private savings. It has been well documented that Singapore has one of the highest savings rates among the countries listed in the *World Development Report* of the World Bank.

The public sector is by far the largest saver and most of its savings comes from government budgetary surpluses and the operating surpluses of statutory boards. Private savings have been significantly increased by compulsory contributions to the Central Provident Fund, which was continuously raised and reached 50 per cent of gross wages by 1984, with 25 per cent of the contribution coming from the employer and 25 per cent from the employee. However, the employer's contribution rate was cut from 25 to 10 per cent during the 1985/86 recession. Since then, the employer's contribution rate has gradually increased and the employee's rate has gradually decreased to around 20 per cent.

The Government has also encouraged voluntary private savings through the maintenance of low inflation and a consistently positive and stable real interest rate. Other policies that promotes savings include the regulation of savings institutions and protection of depositors from bank defaults. In addition, a government-run postal savings system was also established to attract small savers, and tax-exempt status was granted to interest income from such postal savings. Thus, favourable growth conditions, good policy fundamentals and a compulsory pension scheme account for most of Singapore's saving performance.

I. REGIONAL ECONOMIC COOPERATION

The success of Singapore is also due, to a great extent, to its efforts in promoting and participating in regional economic and political cooperation. Singapore, as a founding member of the Association of South-East Asian Nations (ASEAN), has benefited significantly from the political stability nurtured by this organization in a region once classified as the most turbulent in the world. Political stability in the region has not only prevented costly conflicts among member States but also contributed to a conducive environment so critical to attracting foreign direct investment, which has promoted rapid economic growth in the region, in general, and Singapore, in particular.

In response to external developments, ASEAN has started the process of establishing the ASEAN Free Trade Area which is now estimated to take full effect in 10 years starting from 1 January 1993. This deepening of ASEAN will soon be followed by its widening with new members from the Indo-Chinese states. This augurs well for the regional grouping and its members. At the subregional level, because of new business trends and the need to maintain its competitive edge, in view of its serious land and labour constraints, Singapore in partnership with Johor and the Riau Islands, has established the Southern Growth Triangle. The mutually beneficial exploitation of each other's comparative advantages has improved the competitive edge of the group as a whole and generated significant economic growth and development for all three areas.

Finally, Singapore is also a founding member of the Asia-Pacific Economic Cooperation forum established in 1989. With most of its major trading members as participants of this organization, greater flows of trade and investment should follow. The process is undergoing rapid institutionalization, and emphasis has been laid on eliminating obstacles to trade through tariff reduction, standardization of tariff nomenclature and simplification of customs procedures. As Singapore is highly dependent on trade, it should benefit enormously from the exercises.

J. RELEVANCE AND APPLICABILITY OF THE SINGAPORE EXPERIENCE TO THE INDO-CHINESE COUNTRIES

A broad comparison of basic characteristics will show that Singapore is very different from the Indo-Chinese countries. One of the few common features is that Singapore and the Indo-Chinese countries are located in the dynamic Asian and Pacific region which, besides providing significant spillover effects, may have effective demonstration effects in consolidating the resolve of the Indo-Chinese countries in their effort to achieve successful economic development. This paper has tried to identify some basic factors that have contributed to Singapore's transformation and which may have some relevance and applicability to the Indo-Chinese countries. However, before we discuss that, we need to make an assessment of the internal factors governing the potential of economic growth in both countries.

The Indo-Chinese countries have discarded their command systems and embraced market mechanisms to spur rapid economic development after long years of political turmoil, wars and economic regression. Despite the change in orientation, Cambodia is still bogged down with serious division between the warring factions. Given that economic development is unlikely under the current circumstances, any discussion on economic development is inappropriate until and unless a political solution is reached. The possibilities for the Lao People's Democratic Republic and Viet Nam are much better, although the task is no less daunting. Neither of these countries is engaged in a transition towards democracy and they will therefore continue to remain one-party States within the foreseeable future. Greater political stability and authoritarian Governments have far-reaching implications for the transition process as the political system shapes the political constraints, which in turn are determinants of the speed and sequencing of the transition programme. While such political systems may suffer reversals in the face of serious backlashes as a result of the adverse and differentiated impact of reform outcomes, they face less resistance in dismantling the elements of the command economy through concepts such as the "new economic mechanisms" and "doi moi". Consequently, both the Lao People's Democratic Republic and Viet Nam have quite rapidly and successfully implemented the basic elements of a market economy, hoping to achieve rapid economic results to ensure regime legitimacy and reduce the risks of reversibility.

Systemic reforms in the agricultural sectors in the 1980s have dismantled farm cooperatives, giving greater focus to private initiatives, and these reforms have transformed Viet Nam from a rice-importing to a rice-exporting country. The results are less positive for the landlocked Lao People's Democratic Republic with its hilly terrain. Nevertheless, for both countries, reforms are further strengthened by a better definition of land rights through longer-term leases in the early 1990s. Likewise, state-owned enterprises (SOEs) have been given greater autonomy and have undergone rationalization. Both countries are now embarking on privatization programmes to instil greater efficiency and competitiveness in SOEs. There is also the need to stop the drain on financial resources by a large number of overmanned and inefficiently run enterprises or their failure to realize the full economic capacity of the more profitable monopolies. However, both countries are facing difficulties in this area. First, there is bureaucratic inertia and resistance to change as those affected fear losing their jobs and perks. Second, transfers from the profitable SOEs which were the main source of tax income in the socialist system are not adequately compensated for their losses by the newly introduced market-adapted tax system. Although such financial gaps are expected over the transition period, they nevertheless pose a serious financial strain on the new system. Alternative sources of financing need to be looked at.

Other systemic reforms include:

- Factor market liberalization such as more conducive regulations pertaining to foreign investments and giving employers greater leeway to hire and fire;
- Financial liberalization conducive to a modern banking and financial sector;
- Legal reforms pertaining to property, commercial and inheritance laws;
- Institutional reforms to centralize tax and treasury administration.

For both the Lao People's Democratic Republic and Viet Nam, the transition to a market economy has not been easy and for a number of years both economies were plagued by high inflation. This situation, if not rectified, may have dire consequences similar to those experienced by Russia. Appropriately, stabilization policies such as a market-adapted tax system, drastic curtailing of public expenditure and control of the growth of the money supply and credit have been put in place to dampen inflation. The high inflation rates of the 1980s have indeed been brought down to below double-digit levels. Meanwhile, quantitative restrictions on both imports and exports have been eliminated, and import tariffs and export taxes have been drastically reduced. These policies, coupled with the huge devaluation of the kip and the dong in the late 1980s, and the unification of exchange rates indicate that both economies have set in place not only a more conducive environment for foreign direct investment that will spur future economic growth, but also links between the domestic price system and the structure of international prices and between domestic markets and foreign markets.

The above are basic measures necessary for the transformation of command economies into market economies. While there is broad agreement that these standard measures are effective in making the transition, the next stage of achieving self-sustained economic growth is more difficult. It cannot be taken for granted and may be far more difficult to implement. In this regard, the Singapore experience may be useful in that both the Lao People's Democratic Republic and Viet Nam can draw on their own experiences and adapt the better policies as observed in more successful countries such as Singapore.

Like Singapore, both these countries have implemented reform policies in a more pragmatic manner rather than being constrained by dogma. Although more could have been done, the direction is obviously correct. As such, one area that needs immediate attention is the development of an honest and efficient bureaucracy with the concomitant eradication of corruption. The Singapore experience has shown that this is necessary not only to implement government policies effectively but also to translate human resources into productive activities. Consequently, civil servants should be recruited through a meritocratic system and adequately trained to share the same nation-building philosophy and development objectives so as to translate and implement government policies fairly, efficiently and effectively. Corruption in the command system is so ingrained that to clean it up would be a long-drawn and complicated process where cleansing and disinfecting have to start from the top and move downwards in a thorough and systematic way. Furthermore, to tackle corruption effectively, strong leadership is required, with the strength and moral authority derived from unquestioned integrity to be effective. To this end, both countries need to nurture a political system that would allow only men or women with such qualities to take over political leadership.

We have also noted earlier that it is better to be evolutionary than revolutionary. For instance, we have enumerated how Singapore did not do away with entrepôt trade when the British left but instead built on it, while at the same time pursuing industrialization. In this regard, given that both countries are basically agricultural, greater emphasis should be concentrated on improving productivity in agriculture, particularly rice, by bringing in expertise to improve yields and incurring greater expenditure on irrigation, roads and markets for agricultural produce, and encouraging investments in large-scale plantations for rubber, oil palm, tea, etc. There should be an effort to diversify agriculture into as many products as is possible climatically. For the Lao People's Democratic Republic, in particular, the current focus on developing an industrial sector seems to have caused disengagement of the State from the construction and operation of medium-sized and large irrigation schemes. This development, together with the subsistence character of the agricultural sector, has contributed to the stagnation of the rice subsector since the beginning of the transition process. It cannot be overemphasized that the performance of the agricultural sector needs to improve because, given its dominant role in the economy, it is crucial for economic growth in the Lao People's Democratic Republic. A strong agricultural base would facilitate the evolution of the economy into the new growth industrial sectors.

With respect to the development of its industrial sector, it may be expeditious for the Lao People's Democratic Republic to join ASEAN, now that Viet Nam is already a member. Membership in this regional organization would not only lock in and move forward the restructuring of these economies but would also provide the political stability so important for the attraction of foreign direct investment. The need to participate in the ASEAN Free Trade Area would accelerate economic change so that both economies would develop to a stage where they were comparable with the more advanced ASEAN states.

Finally, the Singaporean experience shows that the key to sustained growth in the information age is a comprehensive package of human resource development. Modern agriculture, modern industry and today's information technology require the whole population, including women, to be literate and knowledgeable in order to be effective participants in these areas. The emphasis should be on English (the business language) and technical education. Investment in human resource would even affect population growth. For instance, once women are given the same educational and job opportunities, they would be less enthusiastic about having large families which can dampen not only their standard of living but that of the whole society. Thus, with the setting up of an incentive system through the market mechanism and appropriate institutions, the human resources so developed can be translated into productive activities that may promote sustained long-term economic development.

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Annex

RECOMMENDATIONS FROM THE WORKSHOP FOR ENHANCING MACROECONOMIC REFORMS IN AND FOSTERING REGIONAL COOPERATION AMONG THE ECONOMIES IN TRANSITION IN INDO-CHINA BY LEARNING FROM THE EXPERIENCE OF THE ASEAN COUNTRIES

A. INTRODUCTION

A Workshop for Enhancing Macroeconomic Reforms in and Fostering Regional Cooperation among the Economies in Transition in Indo-China by Learning from the Experience of the ASEAN Countries was organized by ESCAP in cooperation with the Committee for Planning and Cooperation, Government of the Lao People's Democratic Republic and with the financial support of the Government of Japan. The workshop was convened in Vientiane, the Lao People's Democratic Republic from 18 to 20 December 1995. The immediate objectives of the workshop were (a) to assist the Indo-Chinese economies in transition in the formulation of strategies to accelerate their development, and (b) to assist the Indo-Chinese economies in transition to enhance the effectiveness of their macroeconomic reforms based on the experiences of the ASEAN countries.

In its final session, based on the development experiences of the three ASEAN countries and taking note of the reforms already introduced in the Indo-Chinese countries, the Workshop unanimously endorsed the following recommendations for consideration in implementing future policy reforms within the Indo-Chinese countries.

B. RECOMMENDATIONS

1. The importance of political and social stability was emphasized. Social stability requires both improvements in growth and shared participation of the population in general in the growth process.

2. Sustained economic growth was considered to be heavily predicated on macroeconomic stability. In this respect, the Indo-Chinese countries have to keep up the momentum of their policies for macroeconomic stabilization.

3. In improving macroeconomic stability, attention should be paid to the continued need for prudent management of fiscal as well as monetary policies.

4. The Workshop also urged the need to pursue realistic exchange rate policies in light of the demand for and supply of foreign exchange.

5. The Workshop emphasized the importance of export orientation, as well as openness towards foreign trade and foreign direct investment.

6. The Workshop also felt that, while many market-oriented economic policies had already been implemented in the Indo-Chinese countries, institutions required for their effective implementation needed further strengthening. Such institutional development could encompass legal and accounting systems, property rights, and specific organizational structures to deal with specific issues.

7. The importance of a competent bureaucracy to articulate and implement policies, as well as to run the organizational structure, received a great deal of support from the Workshop.

8. Human resources development was considered to be a critical factor in promoting economic growth and the shared distribution of the fruits of growth.

9. The Workshop felt that the Government had to play an important role in promoting human resources development, and in providing basic education, preventive health care and certain social welfare services.

10. Governments should also examine the feasibility of involving the private sector in human resources development activities. In some areas such as the provision of university-level education, categories of technical or vocational education and curative health care, a greater contribution of the private sector might be sought by charging appropriate fees for services provided by the Government or by inducing the private sector to provide such services.

11. Investment was considered to be an important requirement for growth. While at the initial stages of development some part of investment had to be financed by external resources, including foreign investment, efforts towards mobilizing domestic resources required further strengthening. The role of monetary and fiscal policies in the process was emphasized.

12. The question of foreign direct investment received a great deal of attention. The consensus was that policies dealing with foreign investment should be guided more by considerations of non-discrimination between foreign and domestic investors and less by concerns for control. In this context, there was discussion on attracting foreign investment into agriculture. It was felt that some targeted approaches might be made towards some potential foreign investors, particularly in plantation crops, because foreign investors did not generally invest in subsistence crops.

13. With regard to the reform of state enterprises, the Workshop felt that the programme of privatization had to be carefully structured, taking into account the outputs produced, as well as the availability of financial resources and entrepreneurial and managerial capacities in the private sector. Where privatization in not feasible, efficiency should be improved through such methods as corporatization, partial privatization and subjecting state enterprises to hard bedget constraints.

14. On infant industry protection and import substitution, the Workshop felt that the relevant industries should be carefully selected, protection should be time-bound and the producers should be encouraged to compete in international markets through exports. In addition, the recent changes in the international environment and related constraints should be taken into account.

15. The Workshop paid considerable attention to the issue of poverty alleviation. The consensus was that, while accelerated growth should be the primary instrument for alleviating poverty, there might also be a need for certain target-oriented programmes. The emphasis in such programmes should be on increasing the access of the poor to productive assets and inputs including credit, rather than on their subsidized provision. However, in some highly selective cases some subsidies might also have to be provided.

16. Policies towards equitable growth have to be flexible so as to be able to respond quickly to rapidly changing domestic and external economic environments.